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Perspectives on the social security system of China

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assisted by Aidi Hu, Mike Whitelaw and Hiroshi Yamabana

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The idea of this paper emerged following the conclusion in 2002 of a former project of co-operation between the ILO and the Ministry of Labour and Social Security, the purpose of which was to provide a full diagnosis of the various social insurance programmes in place for the urban population and to provide some relatively specific indicators of directions for future technical developments.

The main authors are Anne Drouin and Lawrence H. Thompson; they have been assisted by the contributions of Hu Aidi, Mike Whitelaw, and Hiroshi Yamabana. In particular, the ILO's knowledge of the system of social security in China has been further updated by a study, led by Hiroshi Yamabana and assisted by Rüdiger Knop and Edward Tamagno, which was completed in December 2005, and by the ongoing observations of Aidi Hu. The present text reflects strongly the technical outputs of the project described above, which was undertaken by a combined team of international experts and ILO specialists. They include, in alphabetical order, Christian Baeza who reviewed the medical insurance programme, Gylles Binet who reviewed the Employment Injury Insurance programme, Zhang Guoqing who coordinated the entire project on behalf of the Government, Kenichi Hirose who reviewed the statistical and financial implications of the overall system, Aidi Hu who reviewed the medical insurance programme with Christian Baeza, Roland Longchamps who reviewed also the employment injury insurance programme, Jose Nicolas who reviewed the investment dimensions of the national social security fund, He Ping who led the national group of experts, Pierre Plamondon who reviewed the pension insurance programme, Mike Whitelaw who reviewed the institutional and administrative issues of the social insurance administration, and Liu Yutong who oversaw the Chinese version of the technical reports. Others have contributed in the form of discussions and comments including Rüdiger Knop, Hiroshi Yamabana and Yujun Lao. Special thanks are extended to everyone of the ILO Office in Beijing for their generous support, namely Zhu Changyou, Zhang Guoqing, Wu Rulian and Chen Qiaoling. Appreciation is due to Geng Shuyan and the heads of the Social Insurance Administration for their invaluable support, in particular in helping the experts to keep abreast of developments in the process of the reform of the system. Patricia Frenette devoted numerous hours to the production and layout of this paper, joined at a later stage by John Woodall.

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Foreword

One of the most significant challenges today for Governments around the world is to ensure the availability of employment, in conditions of decent work, to every member of the working-age population who seeks it. Nowhere is this challenge greater in scope, diversity and intensity than in the People's Republic of China. At the same time, as the country's economy grows rapidly and adjusts to the demands of the global market place, the system of social security for China's 700 million workers has also entered an ongoing period of transformation. Over the last decade, the evolution of China's enterprise system towards a recognizable market economy has been mirrored quite naturally in a transformation of its social security provisions from an enterprise-based system of social support to one following the principles of public social insurance.

The challenge of developing China's social security system to meet the needs of workers in all parts of the country for income maintenance in the face of such "contingencies" as old-age, unemployment, sickness, employment injuries and accidents and maternity, is multi-dimensional. One dimension is the urgent need to extend coverage as quickly as possible to all workers; another is to ensure that institutions, which historically reflect strongly the organizational culture of China's public administration, should have or acquire the necessary capacities to fulfil their role of meeting such needs. A crucial element in achieving these objectives has been a high level of collaboration and cooperation between many actors, notably the State Council and the concerned line ministries, and in this regard remarkable results have been achieved within a short time-span.

Broadly, the objectives of the social security system are to provide an appropriate, decent, level of income maintenance for individuals needing to claim benefits under the various social security branches, including the mandatory basic pension system along with the schemes of medical insurance, unemployment insurance and employment injury insurance. Together with the public programme of the minimum living standard guarantee financed from general government resources, these schemes provide a degree of "consumption smoothing", based on a formal scheme of income redistribution. However, such schemes also offer, in a manner which is recognized as increasingly important, a valuable approach to the problems of poverty prevention and reduction.

The sheer size of China, and the provincial political structure, has provided the opportunity to develop and test a considerable range of initiatives for social security provision on a "pilot" basis. Some early, but promising trials have been focused on economically less well-developed areas such as Liaoning Province, and enable experience to be gathered before definitive legal instruments are promulgated at the national level. At the same time, the central institutions are able to pool the experience and know-how which is gained, and to "fast-track" the adoption of, for example, management tools reflecting the most modern information technology in a remarkably uniform manner throughout the country.

The evident need at the present time is to extend the various social security programmes to all workers and their families, to guarantee the financial sustainability of the system in the long run, and to redistribute the system's resources across the widest possible geographical base – in summary to meet the needs and expectations of its population in the light of the country's growing wealth. Clearly, the effort to achieve these aims must not slacken. Yet the foundations of the social security system of China are strong, and the ILO looks forward to playing its full part as this work goes forward in the new millennium.

List of abbreviations and acronyms

BHIS	Basic Health Insurance System
BSIA	Bureau of Social Insurance Administration
BSIFM	Bureau of Social Insurance Funds Management
BSIM	Bureau of Social Insurance Management
CPI	Consumer price index
CCOCPC / CPC	Central Committee of the Communist Party of China
CCP	China Communist Party
CHIS	Cooperative health insurance system
COE	Collectively-owned enterprise
Danwei	Workplace unit
DB	Defined benefit (pension approach)
DC	Defined contribution (pension approach)
DLSS	Department of Labour and Social Security
EII	Employment Injury Insurance
GHIS	Governmental health insurance system
HI	Health insurance
IB	Invalidity benefit
ID	Identification
ILO	International Labour Organization
IMSA	Individual Medical Savings Account
IT	Information Technology
LCS	Labour contract system (introduced in mid-1980s and institutionalized in 1995 in context of the Labour Law)
LHIS	Labour health insurance system
MI	Maternity insurance
MLSG	Minimum Living Standard Guarantee
MOC	Ministry of Construction
MOCA	Ministry of Civil Affairs
MOE	Ministry of Education
MOF	Ministry of Finance
MOLSS	Ministry of Labour and Social Security
MOP	Ministry of Personnel
MOPH	Ministry of Public Health
NaCSSeF	National Council for Social Security Fund
NSSF	National Social Security Fund

OSH	Occupational safety and health
PAYG	Pay-as-you-go
PCs	Personal Computers
PF	Pooling Fund
P.R. China	People’s Republic of China
ROSC	Reforming Office of the State Council
RMB	Renminbi yuan
RSC	Re-employment service centre
SAR	Special administrative region
SAW	Social average wage
SB	Sickness benefit
SDMB	State Drug Monitoring Bureau
SDPC	State Development and Planning Commission
SETC	State Economic and Trading Commission
SFPC	State Family Planning Commission
SIFAB	Social Insurance Fund Administration Bureau
SIA	Social Insurance Administration
SIF	Social Insurance Fund(s)
SIL	Social Insurance Law
SOE	State-owned enterprise
SS	Social Security
STB	State Taxation Bureau
STCMB	State Traditional Chinese Medicine Bureau
TFR	Total fertility rate
TVE	Township and village enterprise
UCHS	Urban community health services
UI	Unemployment Insurance
USD	United States dollar
WTO	World Trade Organization
WS	Work safety

Introduction

In the 1990s, the Government of China embarked on the major challenge of opening its economy. At the same time, it began to adopt a set of sustainable social measures suitable to a market economy and the requirements of a mobile labour force. Early initiatives focussed on measures to ease the reform of the state-owned enterprises throughout the country. Progress has been rapid, and this initial stage has largely been completed. China's economy has expanded rapidly, in the context of globalisation, and it has both become a major force in, and increasingly integrated into, the global economy. Now, therefore, attention is turning increasingly towards the equitable distribution of the benefits of the expanding economy. It is seen clearly that the guiding role of the State is crucial in this regard, and that the fundamental instrument to achieve this objective is the public social security system. We may remark that this approach accords closely with the principles which underlie those promulgated by the ILO, and expressed, for example, in its Convention number 102 concerning minimum standards for social security.

Historically, the framework for the delivery of social programmes in China, including not only income support, but also education and housing, was, for urban workers and their families through work units at the enterprise level, and for rural workers through collective arrangements through the communes. The nature of the social provisions available to, respectively, urban and rural populations were, therefore, rather different in both kind and in philosophy. The growth of the social security systems over the last twenty years or so reflects the development of the country's enterprise system during that period, and we may trace a few "landmarks" along the way. By the late 1980s, it had become clear that attention was needed to the previously unknown phenomenon of unemployment, following the introduction of formal labour contracts. Following the adoption of the Labour Law in 1995 and the beginning of reforms to the State-Owned Enterprises (SOEs), attention was focussed increasingly on the reform of the old-age pension insurance system; this task is continuing. The unemployment insurance system has been further refined beyond the scope of SOE reforms. At the same time — the late 1990s and early 2000s — considerable effort has been devoted to the extension of the public medical insurance system to the entire country. Most recently, the provisions for employment injury coverage have been brought within the scope of social insurance, so that the responsibility for benefit provision in the case of fatal accidents at work has been assumed by the public system rather than being left to employers.

The necessary work to establish appropriate legal foundations governing each benefit branch within the overall system of the social security scheme has now been completed in large measure, but much remains to be done to achieve full implementation of the reform process for all of the schemes. Success in this regard will depend largely on the ongoing provision of adequate resources and administrative capacity at all levels of the administration. The social security system in China has developed in a way that is (by comparison with most other countries) relatively highly decentralized, and yet relies on the collaboration of many Government Departments at the national, as well as the provincial levels. Accordingly, it is crucially important that the many "stakeholders" in the system, including not only the administrators and other officials, but also the employers and workers, must do so on the basis of a high level of awareness and active participation. Social security systems — in any country — must respond to economic and demographic conditions that change constantly, and in that sense reforms can never be regarded as being finished "once and for all". Nevertheless, in China, a relatively high level of effort continues at present towards the achievement of benefits that adequately meet needs, that are distributed equitably and efficiently, and that can be provided at an affordable cost. The Government has adopted a prudential approach, trialling a number of reform options on a pilot basis, mainly in several provinces of the North East, and in seeking the widest possible consensus before crystallising a definitive policy framework for the social security system to be adopted at the national level and enshrined in national law.

A *Memorandum of Understanding* was concluded between the ILO and the Ministry of Labour and Social Security in 2001, within the framework of which a series of technical studies have been jointly undertaken by the ILO and the Ministry of Labour and Social Security (MOLSS). These were finalized in 2002 under the final project report entitled "Review of the urban social security system — pension insurance, unemployment insurance, health insurance, maternity insurance, employment injury insurance and sickness and invalidity benefit provisions". A detailed technical analysis was undertaken of each of the social insurance benefit programmes, by a team of 9 high-level international experts, supervised on behalf of the ILO by Anne Drouin, and working with a team of 13 national experts, coordinated for the National Academy of Social Insurance of the MOLSS by He Ping. A high-level tripartite seminar held on 12 March 2002 in Beijing, at which agreement was reached on a set of recommendations for future directions for the development of technical cooperation in all aspects of the social security system of China. This *modus operandi* has served as a valuable model for the development of Terms of Reference for future projects in collaboration with other partners such as the European Union.

The essential aim of the present study is an integrated understanding, in its relevant historical context, of the past, present and projected development of the social security system of China. In order to do so, an assessment is made of each of the benefit programmes administered either directly or indirectly under the auspices of the government, including both the social insurance programmes under the supervision of the MOLSS and the social assistance programme administered by the Ministry of Civil Affairs (MOCA). These aspects form the subjects of, respectively, Chapters 1 and 2. Chapter 3 offers a social protection development agenda, designed to address strategic issues and possible directions which policy makers may wish to consider for the optimal delivery of social protection to the people of China.

In view of the fast changing pace of development of the Chinese economy and its social fabric, a static picture of the situation at a given point in time would obviously be of very limited value. The authors have rather, therefore, attempted to provide a set of reflections that should remain valid over time. The views, which are presented, reflect their observations and experience from other countries, to the extent that these provide possible indicators as to the outcome of the recent reforms of the Chinese social security system according to the principles of a socialist market economy. It is obviously a very ambitious task to achieve a full understanding of China's system of social security, and one that can hardly be completed in the frame of a study such as this. The authors' hope is that their work will provoke further thoughts, comments and views that may be shared with our partners both in China itself and elsewhere, and both in and outside the ILO itself.

1. Social, economic, demographic and institutional context

China, home to one of the world's oldest civilizations, is currently also home to one of the world's most dynamic economies. In a quarter century it has transformed itself from a socialist planned economy largely isolated from the rest of the world to one increasingly based on market principles following an export-based growth strategy. This transformation has helped to fuel an extended period of rapid economic growth, but it has also created a host of significant challenges for Chinese society in general and the Chinese system of social security in particular.

The economic transformation has been accompanied by major changes in the structure of both the Chinese economy and Chinese society. Previously, economic activity in the urban areas was virtually the exclusive domain of state- and collectively-owned enterprises and, in the rural areas was under the control of local communes. High levels of employment under the planned economy were accompanied in fact by high levels of hidden unemployment. In the last two decades, however, the state-owned and collective enterprises have declined dramatically, both in terms of numbers of enterprises and employment, while privately owned and foreign joint enterprises have expanded rapidly. The commune system that dominated rural life has largely faded away. While many millions of jobs have, in effect, "migrated" from one set of institutions to another and from one geographic area to another, at the same time large numbers of workers have been "laid off" and become unemployed. Reform of the labour market has begun, but has gone forward at a slower pace than economic reforms; while the so-called "iron rice bowl" has been largely dismantled, transition measures have clearly been necessary to alleviate the social impact.

The old approaches to income protection, mostly managed at the enterprise level, could not function effectively under the new arrangements characterising the changing structure of the Chinese economy, and it has been necessary for China to completely rebuild its system of social security. New institutions have had to be created to guarantee and deliver benefits under the social security programmes and to manage their financing. The benefit packages have had to be restructured to reflect in a more appropriate way the social protection challenges that arise in a market economy, to adjust to widening regional income differentials, to reflect changes in the relationship between the Chinese state, public institutions and its citizens, and to begin to deal with rapid changes in the age-profile of the population. Many reforms have already been introduced, but much more has to be done before the Chinese social security system will be able to assure appropriate benefits, that adequately meet individuals' needs, that are distributed equitably and efficiently and that are provided at an affordable cost.

This chapter discusses the major challenges that China faces in reforming its social security system. It begins by exploring the economic, demographic and institutional context in which ongoing social security reforms are taking place. It looks first at the dramatic changes occurring in the structure of both the rural and urban economies of China and the geographic imbalances that rapid growth is producing. It reviews the longer-term consequences of past demographic policies and current national and worldwide trends in fertility and mortality rates. It ends with a review of the current economic situation and the relative scope of the current social protection system within the national economy.

1.1. A gradual and pragmatic process of economic, social and labour market reforms

Economic reform in China has been a gradual and pragmatic process, drawing on ideas and theories from many sources, but adapted for the Chinese environment. New concepts have often been introduced on a pilot basis, to be tested in a handful of places where their impact can be carefully monitored. On the basis of experience gained under the pilot conditions, adjustments are made to address any observed technical problems, philosophical concerns and institutional issues. In many cases, the initial approach has then been modified and retested, perhaps in additional locations. Some reforms have been implemented quickly across the country, while others have evolved more slowly. The pace and pattern of implementation generally recognizes both the need to work out technical solutions and to assess the social impacts of particular approaches, and the need to ensure that the speed and direction of change reflects a general consensus.

The pattern of development of the social protection system has broadly followed that of the labour market since the mid 1980s, when the process of reform accelerated, and leading up to the introduction of the Labour Law of 1995. A range of different options has been identified, and tested in different parts of the country with regard to such dimensions as financial viability and ability to attract consensus as to how the system should evolve. Developing such a consensus has proved to be more difficult in some areas than in others and the implementation of reforms within a suitable national framework has proved to be a considerable challenge. Over the years a relatively high degree of economic and fiscal autonomy has been delegated to the sub-national levels, and the way in which social security institutions have developed in response to differing conditions from one province to another has undoubtedly played some part in complicating the process of achieving such a consensus. We may point, for example, to the experience in the provinces of Liaoning, Heilongjiang and Jilin, where the impact has been felt most strongly - and social security systems under trial have had to deal with the consequences - of the closure of state-owned and collective-owned enterprises.[1]

Important aspects of the ongoing process of economic reforms may be traced back to the announcement of the “Open Door” policy in 1978, and the following period up to 1984, when four special economic zones were created in which foreign investment and foreign joint ventures were encouraged (three in Guangdong and one in Fujian province [2]). The reform strategy comprised, firstly, a refocusing of the nation’s foreign economic relations, secondly taking initial, limited steps toward opening up the country to foreign enterprises, and thirdly restructuring the agricultural system. The change in foreign economic relations involved a reassessment of the old “ideals” of economic self-sufficiency, together with the opening of the country to foreign tourism, focusing attention on increasing exports, sending large numbers of students abroad to study and canvassing the world for further ideas as to how reform might proceed. In April 1984, the special economic zones were extended to the fourteen largest coastal cities, including Dailian, Tianjin, Shanghai and Guangzhou.

In this first phase of reform, however, the most significant changes occurred in the rural areas. Prior to 1980, Chinese agriculture operated collectively through a network of local communes. The communes had a near monopoly on the social and economic life of the rural populations, controlling production decisions and the allocation of farm labour. Beginning in 1979, however, experiments were begun in some of the poorer, more remote rural areas with a new system of “household responsibility”, alternatively described as the “contract system”, under which an individual farming family was allowed to work a particular plot of land and retain all proceeds from the sale of their output after delivering a fixed amount of produce to the collective at a given price. The system proved both popular with the rural populations and effective in increasing agricultural output, and it soon spread to the rest of the rural sector. By the mid 1980s, the communes and the commune system had all but disappeared from rural China. The impact on agriculture in the early years was dramatic. For example, between 1980 and 1995, total grain production in China increased

[1] In 1998 alone, the top three provinces where lay-offs were most important include Liaoning province where 11.7 per cent of the 8.9 million employed were laid-off as well as in Heilongjiang and Jilin provinces where the percentage of laid-offs amounted to 10.2 and 9.8 per cent respectively (employment was of 8.2 million and 5.1 million respectively). Cf. China Labour Statistical Yearbook, 1998.

[2] The three cities in Guangdong province were Shenzhen, Zhuhai, and Shantou. The city in Fujian province was Xiamen.

by roughly 50 percent.[3] Amongst countries which have made a transition from collective-based to individual-based agriculture, it is only in China (and Vietnam) that agricultural sector reform appears to have been really successful.[4] Not only was more food produced, but less labour was required to produce it. This transition, however, gave rise to the first of many adjustment problems for the Chinese policy-makers.

China has historically discouraged the migration of rural workers to urban areas, in part because of the difficulty of expanding sufficiently rapidly the supply of food and other necessities in the cities. Thus the different administrative units of the country have been designated specifically as "urban" or "rural", as a basis on which individuals would be registered as residents at birth. The policy under which it is generally expected that individuals would settle at their place of birth or registration allows, however, for many exceptions and has by no means been strongly insisted on at all times or in all places. Social security provisions have largely been tailored around this urban and rural dichotomy. The rules governing social security provision have, however, reflected the overall relative complexity of operating enterprises in the urban areas, and are generally more elaborate than those applicable to rural workers.

To reduce the pressures driving rural-to-urban migration, China has adopted a number of strategies, of which one of the most important has been to provide additional employment opportunities in non-farm enterprises located in rural areas. Initially, township and village governments operated all such enterprises, and they are still known collectively as township and village enterprises (TVEs). In the course of wider reform of the agricultural sector, however, private individuals have also been allowed to organize such enterprises. Between 1980 and 1995, the number of such enterprises grew from 1.4 million to over 22 million, with almost all of the growth occurring in the private sector. Over this period, total TVE employment increased by 100 million, from 28 million to 128 million, of which it is estimated that private or self-employed individuals accounted for 60 million.

This, fairly successful trend may be seen as part of a new approach to reform which began in 1984.[5] Basic elements included the explicit legalization of private entrepreneurship and the introduction of essential supporting market institutions such as bankruptcy laws and security markets. To the policy of developing rural enterprise was added a strategy of reforming the structure and governance of the state enterprises, under which permission was granted where appropriate for the leasing of industrial and commercial enterprises to individuals and collectives. A "factory director responsibility system" was developed in order to encourage the more efficient operation of the enterprises and to facilitate a reappraisal of the competing roles of the party and of enterprise management in the operations of these economic institutions.

Some further changes were introduced in 1986. These included the ending of the existing system of effective lifetime employment guarantees, known colloquially as the "the iron rice bowl". Instead, a system of labour contracts came into effect; these could be of limited duration and that allowed factory directors considerably greater flexibility in matching their labour forces to the assessed enterprise needs. The earliest provisions by way of unemployment insurance were developed at this time. It was not, however, until some years later, with the adoption in 1995 of the new Labour Law, and the 15th National Congress of the CPC in 1997 which adopted an employment strategy based on the principles of the market economy, that the labour contract system was in fact implemented in full, and integrated into the 5-year plan of 1996-2000 and the national long-term objectives to 2010.

3 China Statistical Yearbook 2002, Tables 12–17.

4 The reform process in China may have stalled after the initial decade and a half as aggregate Chinese grain production has not increased significantly since the mid 1990s. Cf. Rozelle and Swinnen, 2004.

5 "Decision of the Central Committee of the Chinese Communist Party on Reform of the Economic Structure," issued October 1984.

Throughout the 1980s, the country's approach to labour market reforms was a matter of deep debate, probably resulting in some moderation of the pace of their implementation, at least in the urban areas. By 1992, however, the direction of reform was clearly established, and the 14^{th} Congress of the Communist Party officially adopted its "Decision on the Socialist Market Economy," endorsing the reform approach and articulating a new economic philosophy, characterized as "market socialism with Chinese characteristics." The Congress also recognized that the structure of the social security system must change to reflect the changing structure of the economy as a whole.

Economic activity and employment patterns began to change rapidly following the 1992 Congress, and large-scale labour mobility became a reality. The role played by the state- and collectively owned sector of the urban economy peaked in the mid 1990s and then began to decline. Between 1995 and 2002, the statistics show that employment in state-owned and collective enterprises fell by 61 million, or 42 percent, although part of the apparent employment decline represents a shift in enterprise structure and ownership. During these years, control of all but about 3,000 of the 114,000 state-owned enterprises was decentralized from Beijing to provincial and local levels; in many cases local governments authorized divestment, partially or entirely, to the non-state sector. The numbers reflect more than just a change in ownership, however. By one estimate, the state enterprises "downsized" by at least 20 million workers between 1994 and 1999, while another 8.5 million were laid off in the next three years.[6]

Simultaneously, employment in privately owned enterprises, including foreign joint ventures and foreign-owned enterprises, expanded rapidly. In these same years (between 1995 and 2002), it is estimated that employment outside the state and collective sector rose by 118 million. In the aggregate picture, the growth of the non-state sector was more than sufficient, in principle, to absorb the excess workers shed by the state enterprises, so that total urban employment increased by 57 million.

Table 1.1 sets these figures in the context of the observed trends in urban employment over the period until the year 2004.

Table 1.1. Employment in urban enterprises, 1978–2003 (millions)

Year	State- and collectively-controlled	Foreign, joint and private	Self-employed	Other	Total
1978	94.9	0	0.2	0	95.1
1980	104.4	0	0.8	0	105.2
1985	123.1	0.4	4.5	0	128.1
1990	139.0	2.2	6.2	23.1	170.4
1995	144.1	13.7	15.6	17.0	190.4
2000	96.0	32.5	21.4	81.6	231.5
2002	82.8	45.8	22.7	96.4	247.7
2003	78.8				256.4
2004	76.1				264.7

Source: China Statistical Yearbook, 2004 (Table 5-1).

A similar shift from the predominance of public to private employment occurred in rural areas, due in part to changes in ownership and in part to shifts among employing institutions. Between 1995 and 2000, employment in collectively-owned TVEs fell by a third, or 22 million. The decline was offset, however, by an increase of almost the same magnitude in employment in privately owned enterprises, as shown in Table 1.2.

China joined the World Trade Organization (WTO) in 2002. By that time, it had grown to be the world's fourth largest exporter and fourth largest importer of manufactured goods,

6 Rawski (2000); and China Labour Statistics Yearbook 2003, Table 2–7.

thus completing the transformation from a society largely isolated from the rest of the world to one of the world's leading exporters and importers in the remarkable time span of less than a quarter of a century, or in other words during a period representing considerably less than the working lifetime of an average Chinese.

Table 1.2. Employment in township and village enterprises, TVEs, selected years 1980–2002 (millions)

Year	Collectively owned	Privately owned	Self Employed	Total
1980	28.3	0	0	28.3
1985	41.5	4.8	23.5	69.8
1990	45.9	8.1	38.6	92.6
1995	60.6	8.8	59.3	128.6
2000	38.4	32.5	57.3	128.2
2002	38.0	35.0	59.8	132.9

Source: China Statistical Yearbook, 2003.

It is to be expected that entry into the WTO will lead to further structural adjustments in the next few years. In particular, China has committed to opening more sectors of the economy to foreign investment and foreign competition and to further curtailing subsidized lending to the remaining state-owned enterprises. Each step is likely to further reduce the role of the state- and collectively-owned enterprises in the Chinese economy and bring about the transfer of additional employment to the private sector. One aspect, which may be of particular significance as regards social security provision, is the increasing likelihood that foreign insurance companies will wish to establish and transact business in China.

The recent economic transformation has produced significant regional imbalances. A large proportion of the new jobs which have been created have been located in the urban centres of seven provinces that line China's east coast, from Beijing in the north to Guangdong (bordering Hong Kong) in the South.[7] These centres have drawn many millions of migrants in search of work. Between 1990 and 2000, the population of the seven east coast provinces grew more than twice as fast as the rest of the country.[8] In these same years, the fraction of China's population living in urban areas increased by 10 percentage points, from 26 percent to 36 percent. By contrast, over the previous 26 years, the proportion living in urban areas had increased by only 8 percentage points. Moreover, average wages in these seven provinces have risen significantly above the levels prevailing elsewhere. Average wages in the most dynamic areas of all — Beijing, Shanghai and Guangdong Province — can be up to twice as high as those found in less advantaged provinces.[9] For example, the highest level of the minimum monthly wage is around 500 to 580 yuan in Beijing, Shanghai and Shenzhen compared with a monthly minimum which may be as low as 250 yuan in cities of the provinces such as Liaoning, Jilin and Sichuan.[10]

Despite high levels of inward migration, since 2002 the more developed provinces of the East Coast have in fact started facing labour shortages, particularly in those industries which are highly labour-intensive. This is because the cost of living is too high in relation to wages offered to attract sufficient rural migrant workers. One apparent result of these stresses has been the development of what are in effect small cities, albeit in areas officially classified as "rural", where industries which are characteristically "urban" may

[7] Three of the provinces, Beijing, Tianjin and Shanghai, are technically provincial-level municipalities.

[8] China Labour Statistical Yearbook 2003, Table 4–9.

[9] China Labour Statistical Yearbook 2003, Table 5–20.

[10] The Regulations on Minimum Wages were promulgated by the Ministry of Labour and Social Security in 2004. The method of calculating the minimum wage is prescribed. The minimum monthly wage should apply to all full-time employees whilst a minimum hourly wage should apply to part-time employees. A penalty equivalent to 25 per cent of the amount less than the minimum wage is levied charged to employers not respecting those new provisions.

have been established in such a way as to avoid the obligations (even if also forgoing the privileges) of those operating in areas classified as urban.

1.2. Implications of economic reforms for social security

Prior to the economic reforms, social protection for urban workers was provided through the mechanism often described as “the iron rice bowl.” A worker was generally guaranteed a job for life in one of the state-owned or collective enterprises. Social protection benefits, including health care, housing, and income supplements, were provided by the enterprise and financed from its budget. Many of these privileges extended to the immediate family of each worker. Even when such a worker became inactive by reason, for example, of old-age retirement, disablement or other “contingencies”, he or she would generally retain their entitlements. Many of the larger state-owned enterprises, in fact, met their obligations in this regard by direct provision of services, through the establishment and funding of, for example, kindergartens, schools, hospitals, and training centres either on or nearby their industrial premises.

The economic reforms of the period since the early 1990s have required a complete restructuring of the social protection system. In the new conditions, state-owned and collective enterprises were expected to become self sufficient, covering their operating costs from their own revenues and no longer relying on unlimited subsidies from the government budget to pay for wages and social benefits other than those related to their immediate business concern. As a result, enterprises could no longer guarantee either lifetime employment or the range of social benefits and provisions hitherto promised. A very large number of such enterprises found that, in order to survive, they were obliged to restructure and shed excess labour. Many millions of workers simply lost their jobs in the restructuring process. When the enterprises survived, the outcome of the restructuring process was, in general, the effective disappearance of the “iron rice bowl”.

Economic reform required at least three major adjustments to the social protection system. Firstly, new forms of social protection had to be created to deal with the immediate need for income support amongst those who lost their jobs in the restructuring process. Unemployment insurance was strengthened to provide benefits comparable with those available on a transitional basis for workers laid off but still attached to their former enterprises. Secondly, new institutions had to be created to manage the social protection system as state-owned and collective enterprises could no longer provide the necessary institutional foundation. Responsibility for financing social benefits, particularly longer-term benefits such as unemployment insurance and pensions, had to be transferred from individual enterprises to larger groups of enterprises. This broader pooling was necessary in order to equalize the burden among enterprises with different age profiles and assure that payments to its workers continued if a particular firm ceased operations. New institutions were required to collect contributions and pay benefits. It has proved a major challenge to bring these new institutions to the point of being able to operate as an efficient and coordinated system. Finally, coverage of workers in the urban system had to be extended beyond the state and collective sectors in order in the first place to assure coverage for the employees of enterprises that were transferred to private ownership, in addition to workers in the new private enterprises being founded. As a matter of practicality, advantage has been taken of the extension of coverage to employees from all enterprises as a key *ad hoc* recourse to maximise the current inflow of income to the social security system so as to be able to meet the current pension and benefit entitlements due to unemployed workers and pensioners, who have earned their rights from the past.

The massive shifts in employment patterns have greatly increased the demand not only for employment services to help displaced workers but also for income support programmes, including both unemployment benefits as such and other forms of temporary assistance specifically aimed at displaced workers. There are, moreover, additional, if indirect, stresses placed on the social security system, through, for example, pressure on the pension schemes to provide benefits earlier than the normal retirement age.

Differences, as between provinces, in rates of economic growth and population migration have led to significant differences in both the need for different forms of social protection and the individual provinces' financing capacities. Again, the challenges have been compounded, arising in this regard from the lack of effective mechanisms for transferring resources from the richer to the poorer provinces.

As regards the rural areas, the development of formal social security provision, with the notable exception of health care, lagged behind the urban areas. Such social protection as existed was provided in effect through the farmer's link to the land and through the commune system. When, as a result of the agricultural reform process, the commune structure faded away, the one set of institutions capable of assuring any form of effective social protection disappeared. The impact on access to health care was dramatic. Whereas the rural cooperative medical programme existing in the late 1970s covered as much as 90 percent of the total rural population, by the end of the 1980s coverage had reduced to around 5 percent of the population. While new programmes are being developed, and China continues to search for ways to improve rural health care, estimates suggest that only about 10 percent of the rural population is presently covered by a social security medical programme. The need for attention to this acute issue of unbalanced social and economic developments as between urban and rural regions is well-understood, and commitments were made in 2004 to extend the rural populations' access to health services more effectively, as part of the wider effort to lift standards of living closer to those of urban areas.

The growth of the township and village enterprises has exposed a further "gap" in the network of social protection coverage. Workers leaving agriculture to join the TVEs have lost their link to the land as a source of social protection, and yet, because these enterprises are classified as belonging to rural areas, have not been able to gain access to membership of the formal (urban) social security schemes. In the early 1990s, a number of voluntary pension programmes were instituted on an experimental basis, as an alternative approach to providing old-age security in rural areas, but have shown mixed and very limited results to date. More recently, China has accelerated efforts to restore health coverage to the rural populace, whether working in the TVEs or in agriculture. The scope for progress in closing this gap in coverage ought to be considerable, as businesses and industries are encouraged to develop in rural areas and may be expected to shoulder some responsibility for helping those regions to develop and share in the country's rapid economic progress.

Neither has it proved easy to establish an equitable basis on which to grant benefit entitlements to those rural-to-urban migrants who have been able to join the urban social insurance system. In principle, coverage under most forms of social insurance (other than unemployment insurance) is granted to rural migrants legally residing in urban areas. In practice, however, the legal status of many such migrants is unclear and coverage is uncertain. It is evident that increasing numbers of workers are engaged in "flexible" forms of employment, and that those employed in the so-called "informal economy", are rarely issued with labour contracts. Such workers tend to be neither formally registered nor counted accurately in the statistics, but it seems likely that the majority are in fact rural migrant workers. In 2003, a legislative review began of the situation of rural migrants taking up employment in urban areas, as a result of which the requirements for approval on the part of such individual workers, and of their recruitment by enterprises in urban areas, were relaxed. While it seems that the new arrangements, based on the provision of a temporary residence card, may prove difficult to implement and monitor, and have yet to come into effect many areas, they are nevertheless expected eventually to significantly ease labour mobility and to improve the social protection of migrant workers.

1.3. Demographic developments and ageing

The challenge of adjusting China's social protection system to suit the changing economic paradigm is complicated by the additional challenge of the country's changing demographic structure. Past declines in fertility and continued increases in life expectancy are causing the population to "age" quite rapidly. Although similar demographic changes are occurring in most countries, the trends are particularly powerful in China, reflecting (in part) the restricted family size prevailing since the 1970s.

China's total fertility rate fell from an estimate of 6.1 children per woman in the late 1960s to 3.3 children in the late 1970s and further to 1.6 children in the early 21st century. At the same time, life expectancy at birth has increased by over ten years since the late 1960s; for men the increase over the period between 1965–70 and 2000–2005 has been from 58.8 years to 68.9 years, and for women over the same period from 60.4 years to 73.3 years. Viewed on an individual basis, declining fertility means fewer children to share the burden of caring for each set of aging parents and longer life spans mean more years over which care must be provided. If the aged were expected to rely exclusively on their children for support, and the one-child policy is applied for the indefinite future in China's urban areas, the eventual result would be that each adult couple will be the sole source of support for four parents and/or eight grandparents.

On an aggregate basis, these demographic changes have already begun to produce significant shifts in the age structure of the Chinese population, and will result in even more dramatic changes in the years to come. So far, the major impact has been a reduction in the proportion of the youth population (those under age 15) and an increase in the working age population - those aged between 15 and 64 (Table 1.3). The youth population fell from 41 per cent of the total in 1964 to 23 per cent in 2000. At the same time, the working age population increased from 56 per cent of the total in 1964 to 70 per cent in 2000. In these same years, the proportion of the population that was aged 65 and over almost doubled, although from a very small base, rising from 4 per cent in 1964 to 7 per cent in 2000.

Table 1.3. Main demographic indicators, 1953–2000

	1953	1964	1982	1990	2000
General population (millions)	594.4	694.6	1'008.2	1'133.7	1'265.8
By age group:					
0–14	36%	41%	34%	28%	23%
15–64	59%	56%	62%	67%	70%
65 and over	4%	4%	5%	6%	7%
Age dependency ratio[1]	0.07	0.06	0.08	0.08	0.11
Population by residence:					
Urban population	13%	18%	21%	26%	36%
Rural population	87%	82%	79%	74%	64%

[1] Population aged 65 and over divided by population aged 15 through 64.

Source: China Statistical Yearbook, 2001.

In making the latest population projections for China, the central estimates of the UN Population Division include an assumption that fertility rates will rise to 1.85 children per women in the near future and remain at that level until at least 2050. It is also assumed that life expectancy at birth will rise by some five to six years between now and the year 2050, to reach 73.9 years and 79.7 years, for men and women respectively.

In combination with past fertility and mortality trends, the assumed future changes are and will continue to bring about a rapid shift in the age structure of the Chinese population. The projections indicate that the proportion under age 15 will probably continue to decline, accounting for just 16 per cent of the total by 2050. There is likely to be little change in the proportion in the working age range (15 to 64 years) until the year 2025, but thereafter this proportion is also expected to begin to decline, falling by 9 percentage points between 2025 and 2050. On the other hand, the percentage aged 65 and above is expected to triple, rising from 7 percent of the total population, as measured in the 2000 census, to 23 percent by 2050. If these projections are borne out in reality, then the impact of continued low fertility will eventually (beyond the year 2025) be reflected in the beginning of a decline in the total population. (Table 1.4)

Table 1.4. Projected demographic indicators, 2000 to 2050

	2000	2025	2050
General population (millions)	1265.8 m	1445.1 m	1395.2 m
General population by age group:			
0–14	23%	18%	16%
15–64	70%	69%	61%
65 and over	7%	13%	23%
Age dependency ratio[1]	0.11	0.20	0.37
Population by residence:			
Urban population	36%	57%	n.a.
Rural population	64%	43%	n.a.

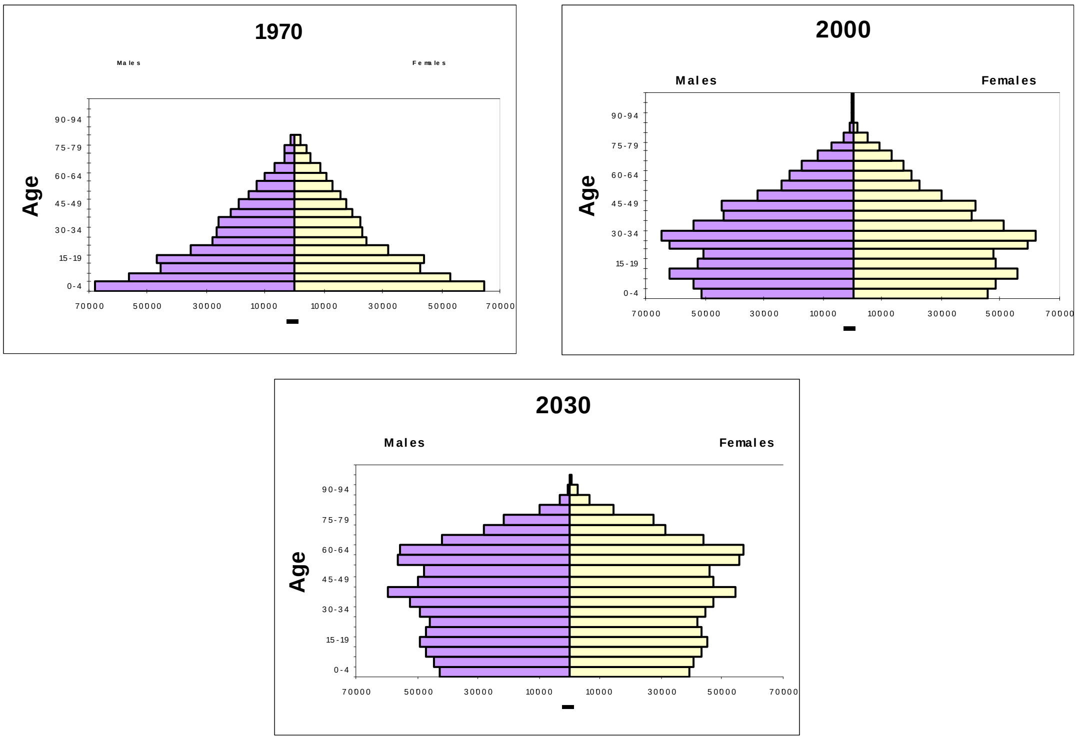
[1] Population aged 65 and over divided by population aged 15 through 64.

n. a.: not available.

Source: United Nations Population Division, 2002 medium variant projection.

Rising age dependency ratios will increase the relative (per capita) cost of both pension and health insurance programmes. As the relative proportions of the population tilts from the "active" (15 to 64) towards the "aged" (65 and over) group, (and in the absence of offsetting changes in retirement ages, coverage rates, or benefit levels) the pension and health benefits provided to the aged population must consume an increasing fraction of the output produced by the active population. The change in the age profile of the population expected over the next 30 years, as compared with that over the last 30 years is illustrated by means of the "population pyramids" presented in Figure 1.1

Figure 1.1. Population pyramids, China, 1970, 2000 and 2030 (*Source*: United Nations Population Division)



1.4. Rapid ageing and its implications for social security

The ageing of China's population has profound implications for its pension and health care systems. The pension system has now operated on what is essentially a pay-as-you-go financing basis for more than thirty years. In a pay-as-you-go system, the contribution rate required to finance a given year's benefits is determined simply by two basic ratios, namely the "system (or age) dependency ratio", which is the ratio of pension beneficiaries to contributing workers, and the "global average replacement rate", which is the ratio of the average benefit to the average wage upon which contributions are being paid. The contribution rate needed to finance pension benefit payments is simply the value obtained by multiplying these two numbers together.[11]

The contribution rate required to finance health insurance benefits can be determined using similar calculations if separate estimates are made of the rates required to finance, respectively, benefits for the working age population and for the aged population. The current rate required for the working age population is usually calculated simply as the average health insurance benefit expenditure per worker divided by the average wage. The additional rate (payable by or on behalf of the working population) required to finance health benefits for the aged population is the ratio of the average benefit (for aged individuals) to the average wage, multiplied by the system dependency ratio (see above). Experience in most countries suggests that changes in the system dependency ratio, year by year, have a less dramatic impact on health insurance costs than on pensions, but there is a strong observed tendency for per capita health spending to rise more rapidly than average wages.

In China, the statutory retirement age is currently 60 for men, 50 for most women, and 55 for women in managerial positions. Accordingly, the "age dependency ratio" reflected in the measured pay-as-you-go social security costs is approximately equal to the number in the total population of men age 60 together with that of women aged 50 and over, expressed as a ratio to the total of the population of men aged 15 to 59 and of women aged 15 to 49. The figures in Table 1.5 show how the age dependency ratio calculated in this way may be expected to change over time, and the impact on the ratio expected in 2050 of various adjustments in the retirement provisions.

Table 1.5. Population dependency ratios, selected years for given retirement ages

Retirement age and year	Dependency ratio
Men at 60 and women at 50	
2000	0.23
2025	0.51
2050	0.76
Both men and women at 60	
2050	0.56
Both men and women at 65	
2050	0.37

Source: ILO calculations based on United Nations Population Division, 2002 medium variant projection.

For China as a whole, the age dependency ratio associated with current retirement rules was 0.23 in the year 2000. These projections suggest the ratio will double before the year 2030, and will triple before 2050. This implies that, if the ratio of beneficiaries to workers under the pension system develops in rough proportion to changes in the age structure of the population as a whole, then the contribution rate required to finance a given pension replacement rate would also triple between 2000 and 2050; the contribution rate required

[11] A slightly higher rate would be required to include the cost of administering the programme, if that is to be financed through contributions. Investment income could allow a somewhat lower contribution rate, depending on the rate of return earned on the portfolio and the desired rate of growth of the portfolio.

to finance health insurance would also increase substantially, even if rather less than proportionately. However, this analysis assumes that other parameters of the system remain unchanged. One change that may attract consideration at some time in the next few decades is an increase in the statutory retirement age, for men, women or both; such a change would have a significant impact on the age dependency ratio and, therefore, the cost of paying pensions and health insurance benefits to the retired population. For example, increasing the retirement age for women to the level now applicable to men is estimated to reduce the dependency ratio in the year 2050 by 20 percentage points, or about one-quarter. Increasing the retirement age for both men and women to age 65 would cut the 2050 aged dependency ratio by half, offsetting most (though not quite all) of the increase projected for the period 2000 to 2050.

In fact, the current "best estimate" projections suggest that the demographic outlook, and development of the expected age dependency ratio for those covered by the pension system in China as a whole is more challenging than for the population as a whole. Moreover, under the system as administered at present, the observed global average replacement rate is relatively high. As shown in Table 1.6, in 2002 the age/system dependency ratio was 32 percent, meaning that there were just over three workers for each retiree. Meanwhile, the average benefit that year was 71 percent of the average wage. Thus, the contribution rate required to finance pension benefit payments in 2002 (on a pay-as-you-go basis) was just under 23 percent of relevant wages or earnings. The relatively high system dependency ratio reflects, to some extent, the fact that the impact of the population ageing process is seen more sharply among the urban population than in the country as a whole, and also that pension system coverage is proportionately higher among state and collective enterprises, which have workforces whose age profiles are older than average.[12] Even if, between now and 2050, means could be put in place to restrict the growth of the system dependency ratio to a doubling (rather than tripling) of the current figure, the contribution rate needed to finance current pension replacement rates would still rise to more than 40 percent, almost double the current required figure. Health insurance costs could also be expected to increase substantially, if by a rather smaller factor.

Table 1.6. Implicit pay-as-you-go cost rate (PAYG) of China's pension system, 2002

Actual 2002 pension system dependency ratio:	
Pension beneficiaries (millions)	36.1 m.
Pension system contributors (millions)	111.3 m.
Dependency ratio (A)	0.32
Actual 2002 pension system average replacement rate:	
Average pension benefit (yuan)	8,087 p. a.
Average urban wage (yuan)	12,422 p. a.
Average replacement rate (B)	71%
Implicit cost rate for pension benefits (A) * (B)	23%

Source: ILO calculations based on data from Chinese Labour Statistical Yearbook, 2003.

1.5. The context of social protection in 2005

Over the last quarter century, China has experienced rapid and sustained economic growth. Between 1978 and 2002, per capita real gross domestic product (GDP) grew at an average annual rate of 8 percent per year and real average annual wages in urban employment grew at an average annual rate of 6.2 percent per year. Although these figures certainly represent an impressive rate of sustained growth, some caution is needed in their interpretation (see commentators such as Rawski, 2000), given that the growth developed from a very low

[12] Among provincial level governments, the four with the highest age dependency ratios are the municipalities of Beijing, Shanghai, and Tianjin along with the urbanized province of Zeijiang.

initial base, and per capita gross domestic product in 2002 had still to cross the equivalent of US$1,000 (Table 1.7).

Table 1.7. Measures of economic activity in China, 1978–2002

Aggregate economic activity, 2002	**Yuan**	**US dollars**
Gross domestic product (billions)	10,470	1,266
Gross domestic product per capita	8,184	988
Shares of 2002 gross domestic product:		
Wages and related incomes		51%
Savings		31%
Average annual real growth rate, 1978–2002		
Per capita GDP		8.0%
Average annual wage in urban enterprises		6.2%

Source: China Statistical Yearbook, 2003.

Annual earnings in urban enterprises averaged 12,422 yuan in 2002, or about US$1,500. Earnings levels vary substantially by region and type of enterprise. In Beijing and Shanghai municipalities, two of the most prosperous areas in the country, average earnings were estimated to be 75 to 93 percent higher than the national average. On the other hand, in the least prosperous provinces average earnings were found typically to be at a level of only about three-quarters of the national average. The gap between the richest and the poorest may be said, therefore, to be roughly two to one. Nationally, average earnings were highest among foreign-funded enterprises and lowest among collective enterprises. As a group, state-owned enterprises appear to have pay levels close to the national average. Part of the gap between foreign-funded enterprises and others, notably state-owned enterprises, can be traced to the fact that the foreign-funded enterprises are more likely to be located in higher wage areas. For this reason, amongst enterprises located in Shanghai, the highest wage-level area of all, the gap between foreign and state-owned enterprises was found to be notably smaller than the gap nationally.

Table 1.8. Wage distribution, 2002

	Yuan	**Percent of overall (national) average**
Average annual wage in urban enterprises	12,422	100
Average by region		
Shanghai	23,959	193
Beijing	21,852	176
Shanxi	9,357	75
Henan	9,174	74
Average by type of enterprise (nationally)		
State-owned enterprises	12,869	104
Urban collective enterprises	7,667	62
Joint ownership units	12,451	100
Domestic share holding corporations	13,850	111
Foreign-funded units	17,892	144
Average by type of enterprise (Shanghai)		
State-owned enterprises	24719	199
Urban collective enterprises	14851	120
Joint ownership units	18015	145
Domestic share holding corporations	25046	202
Foreign-funded units	30192	243

Source: Chinese Labour Statistical Yearbook, 2003.

Table 1.9 shows the aggregate spending on major social security programmes in 2002. The pension programme is by far the single largest element of the Chinese social protection system, accounting for 82 percent of all social insurance spending. Medical insurance is the second largest, representing 12 percent of the total. Unemployment insurance accounts for five percent of spending, and the remaining two programmes, work injury and maternity insurance, together comprise just below one percent.

There are three other significant national programmes that provide additional social protection facilities supplementing the social insurance programmes. The largest of these is the network of Reemployment Service Centres that were set up to assist workers who lost their jobs in the course of the restructuring of state enterprises. In 2002, total spending on these centres exceeded spending on the unemployment insurance benefits. However, even in that year, spending had declined below that for, say, the year 2000, reflecting the beginning of a programme to phase out these centres. Secondly, the Minimum Living Standard Guarantee is a social assistance programme that provides a minimum income to those with few or no other resources. It has been expanding recently, but still operates almost exclusively in urban areas. The third of these supplementary programmes is the Voluntary Pension Programme, which dates from the early 1990s and is targeted towards the rural populace.

Except for the Reemployment Service Centres, spending has grown rapidly in recent years in all of the country's social protection programmes. Particularly rapid increases have occurred in the medical insurance area, where a new health insurance programme is still being phased in, and in the minimum living guarantee programme. Despite the rapid growth, total spending on these social security programmes is still relatively modest. Expenditures in 2002 under all five social insurance programmes combined amounted to between 10 and 15 percent of total government spending and 3.3 percent of China's GDP. The addition of expenditures under the other three programmes outlined above would bring the total to 3.6 percent of GDP. Pensions benefits alone amounted to 2.7 percent of GDP.

Table 1.9. Social protection spending, 2002 and 2003

	2002 Amount (billion Yuan)	2002 % of GDP	2003 Amount (billion Yuan)
Total government expenditure	2,205	21.0%	
Social insurance programmes			
Pensions	284.3	2.71	312.2
Health	40.9	0.39	65.4
Unemployment	18.7	0.18	20.0
Maternity	1.3	0.01	1.4
Work Injury	2.0	0.02	2.7
Total social insurance	347.2	3.31	401.6
Other social protection programmes			
Reemployment Service Centres [a]	18.2	0.17	
Minimum living standard guarantee programme [b]	9.2	0.09	
Rural voluntary pensions [c]	1.4	0.01	

[a] 2.35 billion of the outlays for reemployment service centres were financed from the unemployment insurance programme. Those expenditures are counted twice in this table.

[b] 2003 spending and the increase is from 2001 to 2003.

[c] Based on early estimates of GDP and government expenditure, subject to updating.

Sources: China Labour Statistical Yearbooks, 2002 and 2003; Ministry of Civil Affairs.

All social security programmes appear to have operated, in aggregate, in surplus over recent years (see Table 1.10). This is so in terms of the consolidated situation at the national level, but may not necessarily be so at the level of all of the individual provinces, where the ultimate responsibility for financing deficits rests. While the surpluses generally observed amongst the richer provinces of the East Coast may be regarded, implicitly, as largely offsetting the deficits of the poorer provinces, namely those of the North East; action is nevertheless needed to redress the financial imbalances of the system found in some local situations, and to seek additional resources when annual deficits are incurred.

Table 1.10. Budget balance of social insurance programmes, 1990–2003 (100 million Yuan)

	Total	Old-age pensions	Unemployment insurance	Medical insurance	Employment injury insurance	Maternity insurance
Revenue						
1990	186.8	178.8	8.0			
1991	225.0	215.7	9.3			
1992	377.4	365.8	11.7			
1993	526.1	503.5	17.9	1.4	2.4	0.8
1994	742.0	707.4	25.4	3.2	4.6	1.5
1995	1’006.0	950.1	35.3	9.7	8.1	2.9
2000	2’644.5	2’278.1	160.4	170.0	24.8	11.2
2001	3’101.9	2’489.0	187.3	383.6	28.3	13.7
2002	4’048.7	3’171.5	215.6	607.8	32.0	21.8
2003	4’882.9	3’680.0	249.5	890.0	37.6	25.8
Expenditure						
1990	151.9	149.3	2.5			
1991	176.1	173.1	3.0			
1992	327.1	321.9	5.1			
1993	482.2	470.6	9.3	1.3	0.4	0.5
1994	680.0	661.1	14.2	2.9	0.9	0.8
1995	877.1	847.6	18.9	7.3	1.8	1.6
2000	2’385.6	2’115.5	123.4	124.5	13.8	8.3
2001	2’748.0	2’321.3	156.6	244.1	16.5	9.6
2002	3’471.5	2’842.9	186.6	409.4	19.9	12.8
2003	4’016.4	3’122.1	199.8	653.9	27.1	13.5
Balance at year-end						
1990	117.3	97.9	19.5			
1991	169.7	144.1	25.7			
1992	252.8	220.6	32.1			
1993	303.7	258.6	40.8	0.4	3.1	0.8
1994	365.7	304.8	52.0	0.7	6.8	1.4
1995	516.8	429.8	68.4	3.1	12.7	2.7
2000	1’327.5	947.1	195.9	109.8	57.9	16.8
2001	1’622.8	1’054.1	226.2	253.0	68.9	20.6
2002	2’423.4	1’608.0	253.8	450.7	81.1	29.7
2003	3’313.8	2’206.5	303.5	670.6		

Source: China Labour Statistical Yearbook, 2003 (Table 11–25).

2. Current social security programmes

Social security in the People's Republic of China has gone through several distinct phases. A comprehensive system of social insurance was established soon after the current Republic was established, but that system did not continue beyond the period of the "Cultural Revolution" that began in 1966. A new system was created in the mid 1970s under which individual employers were required to assume responsibility for their employees, and was itself gradually replaced, from the late 1980s onwards, by a network of government-sponsored programmes in which risks are "pooled" across multiple employers. The process of transferring responsibilities from employer responsibilities is not yet complete, and important structural issues remain to be resolved.

The system continues to evolve, in the light of large-scale trials of new proposals and organizational arrangements, and as new programmes are gradually implemented across the country. This chapter focuses on the structure of social security in the country as it is expected to develop on the basis of the principles largely established by 2004. We begin by tracing the historical development of the system, with particular emphasis on the relatively recent transition from a system of employers liability mandates to social insurance. A brief overview is presented of those features of the structure of the Chinese state which are relevant to an adequate understanding of the current organization of the social security system, followed by a discussion of the benefits, financing and administration arrangements for each of the major social security programmes in turn.

2.1. The development and early evolution of the social security system

Phase I

The first approach to formal social protection in China was established through "(Draft) Regulations Concerning Labour Insurance" issued in 1951. These established a system of social insurance covering retirement, disability, death, sickness, maternity, work-related injuries, and medical care. They also included a form of unemployment benefit called "job waiting" relief. Together with the promise of lifetime employment in the state and collective enterprises, the new system created a system, often described colloquially as the "iron rice bowl", of social security for urban workers.

Initially, the labour insurance regulations applied only to those state and collectively-owned enterprises located in urban areas and employing more than 100 persons. The programme soon spread, however, to government and government-related institutions such as party organizations, schools, hospitals and research institutions situated in urban areas. In 1955, a separate system was set up to cover government employees and party institutions, and in 1958 coverage was extended to all urban enterprises, regardless of size. Coverage was not, however, extended to farmers and enterprises located in rural areas.

This early system was financed entirely by employers. The pension system was financed through explicit contributions levied on the enterprise wage bill and was administered by local trade union committees. The local committees operated under the administrative jurisdiction of the All China Federation of Trade Unions (ACFTU) and under the policy supervision of the Ministry of Labour in Beijing. The contribution rate for pensions was 3 per cent of wages. Beginning in 1954, 30 percent of the funds raised were transferred to a national pension fund that was managed by the ACFTU; the other 70 percent were managed by the relevant local administering authority. The national fund was conceived as the mechanism for subsidizing future pensions costs in regions experiencing unfavourable economic or demographic developments, thereby producing a nationally-uniform pension system.

It is interesting to note that the initial parameters of the pension system were similar to the system then in effect in the Soviet Union. Pensions were made available to men at age 60 after 25 years of service and to women at age 50 (for blue collar workers) or age 55 (for white collar workers) after 20 years of service. Those employed in hazardous occupations were eligible to receive benefits five years earlier than the normal retirement age to account for the difficult work conditions and their adverse health effects on individual workers. Pensions varied in general from 50 to 70 percent of the retirees' average wages at the time of retirement.

Phase II

In fact, very few workers qualified for pensions in the early years. In 1952, the system covered eight million active workers (on behalf of whom contributions were paid) but paid pensions to only 20,000 retirees. The 3 percent contribution rate was substantially more than needed to cover the initial benefit costs, and the pension funds, under trade union management, accumulated fairly substantial reserves.

This social insurance system was dismantled during the period from 1966 through to around 1976 (that of the of the "Cultural Revolution"). The institutions that had supervised and managed the system, the trade unions, the Ministry of Labour and the local administrative organs were either suspended or dissolved, and the accumulated reserves were appropriated for other purposes. At first, responsibility for pooling of funds and for oversight of the social insurance system shifted to local government labour bureaux. Eventually, however, the pooling of employer contributions ceased and each enterprise became responsible for the provision and financing in full of employee welfare benefits for its own employees. In principle, workers continued to be entitled to social benefits, but these were provided at the discretion of each local enterprise. In practice, many workers found that they were unable to claim payment of pensions on reaching the theoretical retirement age, and were obliged to delay their actual retirements.

Phase III

The third phase in the evolution of social security began in 1978, when new regulations were issued formally establishing employers' responsibility for financing and providing social insurance benefits.[13] Technically, these regulations were applicable only to state-owned enterprises, government, and government-related institutions, but the collective enterprises were also encouraged to follow the regulations, and most did so. The regulations re-established entitlement to social insurance benefits through employer-provided pension, health, maternity, sickness and work injury benefits.

The objectives of the 1978 reforms included facilitating the rehabilitation of workers whose lives had been disrupted during the preceding years, and the creation of employment vacancies in the state enterprises to provide opportunities for new labour force entrants. To help achieve these objectives, the conditions for pension eligibility were loosened and benefits were made more generous. The minimum service for pension eligibility was lowered to ten years. The pension payable to those with between ten and fourteen years of membership of the system was set at 60 percent of their standard pay; for those with between 15 and 19 years membership at 70 per cent of standard pay; and for those with 20 years or more at 75 percent of their standard pay. In addition, a lifetime job in the state sector was guaranteed for one child of each retiree. These liberalizing measures had the desired impact, and in the first 12 months after they were issued, the number of pensioners nearly doubled, from 3.14 million to 5.96 million. Between 1978 and 1985, the pension rolls increased five-fold and the costs of the pension system rose from 2.8 percent to 10.6 percent of the aggregate wage bill of covered institutions.

[13] Document 104 of 1978, Third Plenary Session of the 11th Party Central Committee.

Phase IV

By the mid 1980s, the pace of economic reform had accelerated and the need to accommodate structural changes in the labour market had become apparent. In 1986 the Government instituted a series of changes that began the processes of deregulating the labour market, adapting the social protection system to a market system, and loosening the "iron rice bowl" system of social protection.

Firstly, regulations issued in 1986 created a new system, based on formal contracts, to replace the system of permanent employment that had been established thirty years earlier. While those already employed would remain under the permanent employment system, the employment of a new employee at state- and collectively-owned enterprises was to be governed in each case by a labour contract, which could be either fixed or indefinite in term. Secondly, in recognition of the new degree of uncertainty being introduced into the labour market, the Government instituted an unemployment insurance programme. In addition, a restructuring was begun of the system for administering the social insurance programmes, progressively relieving employers of the responsibility for benefit administration, particularly for longer-term benefits.[14] Urban administrations were required to create social insurance agencies to assume oversight of the social insurance programmes in their areas and to begin pooling the unemployment insurance contributions and the pension contributions collected from and on behalf of the new contract employees. In addition, employees were required for the first time to pay a share of the contribution rate, so as to help finance the pensions of the contract workers, who were themselves brought within the scope of all of the other existing social insurance arrangements, including health care, sickness, and work injury. Localities were also encouraged to extend the principle of contribution pooling, beyond the scope only of the newly hired contract workers, and to test the possibility of extending pension coverage to the newly forming non-state urban enterprises.

The unemployment insurance programme was designed initially to provide benefits specifically for laid-off employees of the state-owned enterprises. From the outset, benefits were financed through pooling of social insurance contributions collected from enterprises. Originally, benefits were scaled to previous earnings and financed by a contribution of one percent of earnings covered by the programme. In 1993, however, the benefits were changed to a "flat rate" basis providing an equal payment for all workers within a locality (although varying from one locality to another).

The late 1980s and early 1990s saw the emergence of a variety of different approaches to social insurance, particularly to pension structure and finance. In effect, in these years social protection policies were allowed to evolve through a process of decentralized experimentation in much the same way as general economic policies were evolving through the experience gained in a variety of special economic zones, with the expectation that a consensus about the best approach for social protection would emerge from the experience of the various approaches being tested in different parts of the country.

By 1991, each local ("county") government had established a social insurance agency and begun some degree of pooling of worker and employer contributions, so that about two-thirds of the employees of the state-owned enterprises were participating in some form of pension pool. However, the system remained quite fragmented. It was common for localities to establish separate pools, not only for state-owned enterprises, collectively-owned enterprises and, where they were covered, the employees of private or joint-ownership firms, but also for contract workers and permanent workers.

In 1991 the Government issued a statement setting out aspects of its pension policy, with a view to establishing a coherent framework for the developing process of decentralized pension reform.[15] The statement envisaged that the obligation to contribute on their own

[14] State Council Document 77 of 1986.

[15] State Council Document No. 33.

behalf would be extended to all employees, including the remaining permanent employees in the state sector. In addition, the statement foresaw the progressive integration of the various different pension pools and programmes by now existing at the local level and their eventual integration into one national programme. It set out a vision for a three-tier pension system comprising: (1) a basic statutory pension financed by employer and employee contributions, (2) supplemental pensions financed by enterprises from operating surpluses, and (3) individual pensions financed on a voluntary basis by workers and available at retirement as either a periodic payment or a lump sum. What the document articulated, however, was essentially a vision, rather than a programme of specific pension reform provisions.

The new economic structure, generally described as the socialist market economic system, was fully conceptualized in 1992.[16] At that time, the need for further reform of the social protection system was acknowledged, but no single approach to either pension or health insurance was endorsed. Individual provinces continued to test different approaches to pension reform. Some emphasized increased social pooling of pension contributions in order to spread the pension burden as evenly as possible across all enterprises. Others introduced, on a trial basis, individual funded accounts. These proved to be particularly popular among the new private and joint enterprises, as these enterprises had few, if any "legacy" pension liabilities relating to long periods of prior service by their employees. Under a system of funded individual accounts, the new enterprises could largely avoid the burden of helping to finance the liabilities of the older enterprises.

Also in 1992, the Government initiated pilot projects with the aim of developing some form of pension provision, albeit on a voluntary basis, in the rural areas. Local governments were to organize pension schemes, which were more or less of necessity in the form of defined contribution programmes, to which individuals, governments, or enterprises could make contributions. That year, moreover, the urban pension system that had been created in 1986 was officially extended to those urban collective enterprises not already participating.

Two years later, implementation began on a pilot basis of a concept called Reemployment Service Centres (RSCs). These spread throughout the country by 1996, and in 1998 were made mandatory for all state-owned enterprises. RSCs provided the framework for an integrated programme combining training, job search assistance, a monthly income and the continuation of social insurance coverage to individuals laid off from the state enterprises. However, the State Council showed itself to be dissatisfied with the results of this initiative, and from the year 2000 onwards, a progressive programme of closure of the RSCs began.

The development of an increasing variety of initiatives in different provinces led inevitably to increased fragmentation, particularly with regard to pension schemes, and it must be said that this has, to a greater or lesser degree, prejudiced the likelihood of achieving the vision of a unified pension system to which the 1991 policy statement pointed. Meanwhile, by the mid 1990s, the traditional system of employer-provided health care was, in effect, collapsing, as a result of the shift in employment from the state- and collectively-owned enterprises to the new private and joint enterprises. Accordingly a rather urgent search began for new strategies for, at the same time, financing and delivering health care and for bringing greater coherence to the "patchwork" diversity of pension provisions.

In 1995, accordingly, the State Council issued a new circular on pensions that established a goal of creating one unified national pension system.[17] The circular set a target for achieving this goal by the year 2000, and envisaged that, by that time, all workers should be participating in a single national system under the auspices of the Government and

[16] "Decisions on Some Issues Concerning the Establishment of a Socialist Market Economic System," 3rd Plenary Session, 14th National Congress.

[17] "Circular on Deepening the Reform of the Old Age Pension System for Enterprise Employees," State Council Document 6.

having, as far as possible, uniform rules, provisions and procedures. Having established the goal of a unified system, however, the document went on to outline three different approaches that provinces might take. One approach (Plan I) was to build schemes around individual accounts to be financed by a 16 percent contribution rate. The contribution rate would be shared between employees and employers, on a basis to be gradually adjusted until one-half was paid by each. Contributions would be deposited in accounts accruing interest on an administered (somewhat artificial) basis to be specified later, but reflecting a combination of the rate of return on bank deposits and the rate of growth of local average earnings. Pooled employer contributions would also finance additional benefits for workers in mid- career at the time the new system was established. A second approach (Plan II) combined a flat-rate "base" pension to be set at 20 to 25 percent of each locality's average wage with an earnings-related pension equal to 1.0 to 1.4 percent of the individual worker's standard wage for each year of service and a pension derived from an account built by voluntary individual contributions. A modified alternative was presented as the third approach (Plan II-B), under which the earnings-related component of Plan II would be omitted, but retaining the combination of a flat-rate base pension and the individual account. In all three approaches, "floor" and a "ceiling" earnings levels were to be established for the calculation of each worker's contribution. The suggested floor was 60 percent of the local average wage, with the ceiling to be set at either 200 per cent or 300 per cent of the local average wage.

The 1995 document took a very flexible approach in encouraging the provinces' administrations to adopt any of the three models outlined or any combination of the various features outlined in the circular. In due course, the different provinces exercised their individual choices in his regard, which, however, resulted ultimately in a further degree of fragmentation of the pension system overall. A reasonable degree of consensus about how the pension system should be structured may be said to have emerged two years later, when in 1997 the State Council issued a new directive on pensions, called for the creation throughout the country of a system resembling Plan II-B of the 1995 document.[18] Pensions were to consist of three parts, a base pension equal to 20 percent of the average wage of the province, an individual account that provided a pension based on the account balance at retirement, and a transition benefit to compensate workers in the middle of their careers when the individual account approach was instituted.

Although the new directive made significant progress towards a nationally uniform system, certain important points of design and associated parameters have yet to be specified. In particular, no specific statement has been issued to indicate whether it is intended that an individual worker's account should be maintained on a "real" (advance funded) basis or simply as a nominal record of contributions (and theoretical accumulations) until retirement. In practice, most provinces have treated members' accounts on a "notional" basis, and, and have accumulated few, if any, "real" pension reserves. At the end of 2002, aggregate reserves in the pension system amounted to 161 billion Yuan, a figure roughly equal to 55 per cent of that year's actual total pension expenditures.[19]

Two measures were introduced in the year 2000, with a view to increasing the role of advance funding in the pension system. Firstly, pilot programmes have been launched in selected provinces, beginning with Liaoning, designed to test several proposed revisions to social insurance policies. One such was the creation of a provincial-level fund to hold all of the contributions that were earmarked for individual accounts, which would have the merit of limiting the diversion of current contributions to pay the pensions of current retirees. In addition, a new national institution, the National Council for Social Security Fund (NACSSEF), was created. This organization is a state agency directly responsible to the State Council. Its function is to manage funds that are raised by the central government, mainly through the sale of shares in state-owned enterprises, and set aside to help cover future social security costs. These measures do not in themselves amount to a fully detailed

[18] State Council Decision 26.

[19] Labour Yearbook, Table 11–29

strategy as regards the future financing of the strategy for the pension system, but do go some way in that regard.

The State Council and the Ministry of Labour and Social Security have also initiated measures strengthening other parts of the social security system. These include interim regulations on Occupational Injury and Disease Insurance for Employees in Enterprises, which were issued by the Ministry in 1996 and which extend the principle of pooling of social insurance contributions to the occupational injury programme.

In 1998, the State Council selected a new model for urban workers' health insurance, to be called the Basic Health Insurance System. This system is designed to rely on a combination of individual accounts to finance out-patient care and social pooling to finance in-patient care. A period of two to three years was envisaged to allow for the new system to be phased in progressively, and to replace the combined provisions of the existing Labour Health Insurance System and the Government Health Insurance System, each of which comprised essentially employer-mandated provisions.

Finally, in 1999, coverage of social insurance programmes was extended beyond the state sector to foreign funded and private sector firms. At the same time, employees began to be obliged to contribute to the unemployment insurance programme.

2.2. The Chinese State and social security

Four different levels of government bear responsibilities for various aspects of the social insurance system in China, and ideally they should seek a high level of mutual cooperation in their activities. This section focuses on how the different governmental units establish social insurance policies and administer the programmes. The current arrangements are reviewed briefly, and attention is drawn to the institutional and administrative issues which they raise.

2.2.1. National organization

In the People's Republic of China final authority in relation to any legislative proposal rests with the National People's Congress, which elects the leaders of the Government, enacts basic legislation and oversees the operations of the Government. The National People's Congress is elected for a term of five years and meets in session during the first quarter of each year.

The highest organ of state administration is the State Council, headed by the Premier, and its members include the Vice-premiers, State Councillors, and the heads of 29 Ministries and Commissions making up the first tier of the central government. The State Council has the power to issue administrative and policy directives and oversee the operations of government organizations at all levels throughout China.

Responsibility for the Social Security system rests jointly with the Ministry of Labour and Social Security and the Ministry of Civil Affairs. The former is responsible for all of the social insurance programmes, together with the rural pension programme and also retains authority in relation to the remaining reemployment centres. The latter ministry is responsible for the minimum income guarantee programme. Both Ministers are automatically members of the State Council. China has not, to date, adopted a consolidated "basic law" on Social Security, but has relied on a legislative framework for all of its Social Security programmes comprising Directives from the State Council together with Regulations issued by the relevant Ministry.

At the second level, China is divided into 22 provinces, five autonomous regions, and four municipalities. The autonomous regions and municipalities are granted the same administrative status as the provinces, and for the sake of simplification herein, references to provinces, provincial governments or administrations are generally intended to refer equally to the autonomous regions and municipalities.

Below the provincial (or second) level, administration of the provinces is subdivided into cities, prefectures, counties, townships and villages, and districts. The level immediately below the provincial level (third level) is the city level, which we describe herein — because some large counties have been granted the same administrative status as the cities — again, for the purposes of simplification, as the "prefecture" (city/large county) level. The next level (fourth) is the lowest level of administration for social insurance purposes, which we describe here as the "county level"; this includes those townships, etc. that have county level status and have their own social insurance administrations. A simplified outline of the overall national structure is presented in the diagram on the following page.

2.2.2. Sub-national organization

The Social Security system described in this report offers coverage to members in mainland China, excluding the special administrative districts of Hong Kong and Macao but including Hainan province. The territory covered is divided into 31 sub-national jurisdictions, of which, while we speak collectively of "provinces", technically only 22 have that status as such, accompanied by five autonomous regions[20] and four municipalities.[21] Each province is subdivided into prefecture-level governments, with further successive subdivisions into, respectively, county and township-level administrations. At the end of 2002 the administrations numbered 332 at the prefecture level, 2,860 counties and 44,850 townships. "Cities" are represented at each of the provincial, prefecture or county government levels, and those that form either provincial or prefecture-level governments are divided into districts, which are, in turn, the effective equivalent of counties.

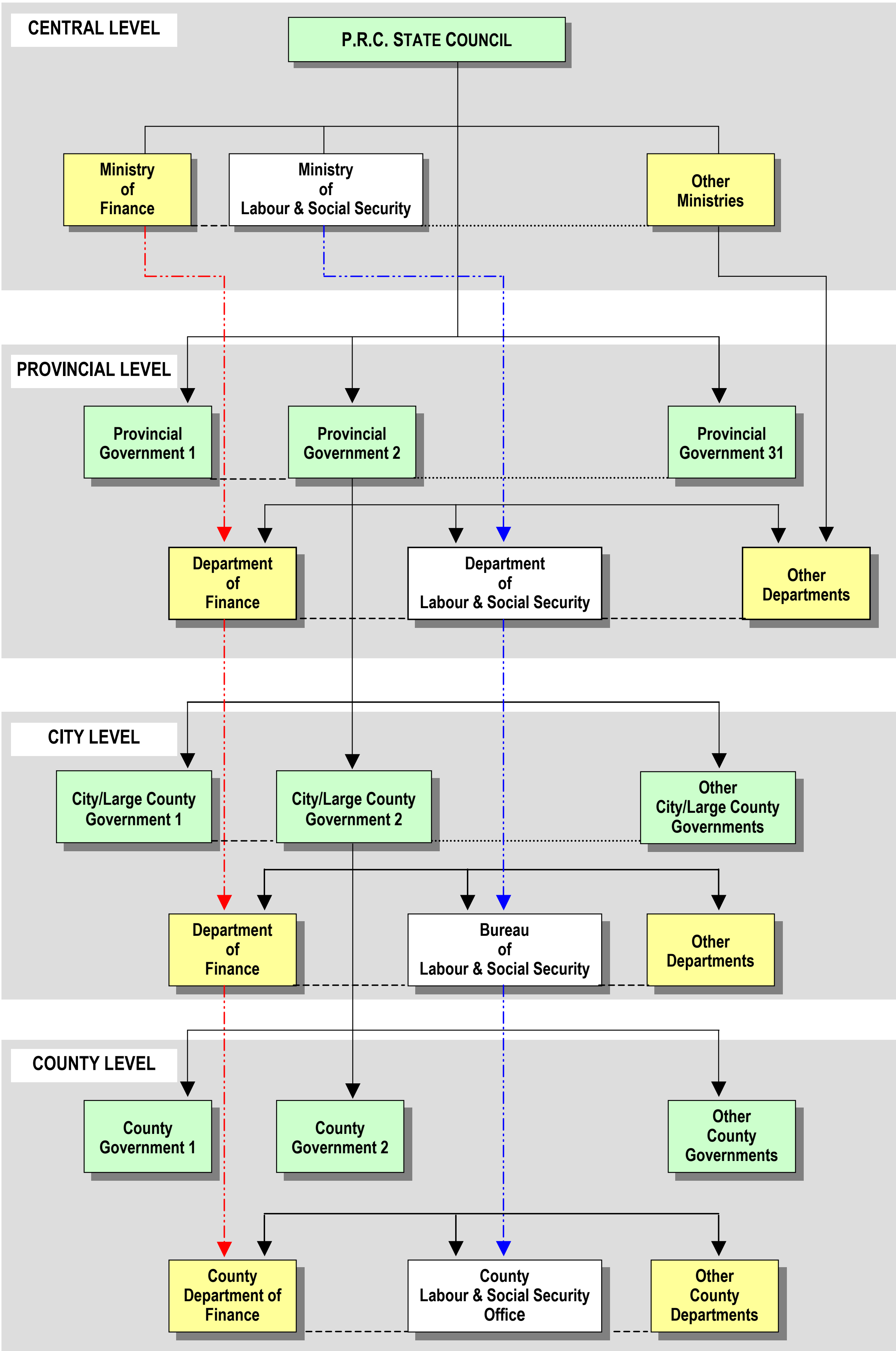
The administration of each prefecture-level government includes a local Ministry of Labour and Social Security, a Ministry of Civil Affairs, a Department of Finance and a Department of Taxation. Each of the prefecture and county-level administrations also includes departments dealing with social security, taxation, finance and civil affairs. Responsibility for administering the Chinese social security system is divided among these various units of the several thousand county, prefecture and provincial level administrations; responsibility for unemployment insurance resides variously with the local social insurance or the local employment services agency.

The (permanent) civil registration of each Chinese citizen is made at a particular geographic location. In principle, it is expected that each individual will reside at the location of their registration, unless they have a valid reason (such as temporary employment or education) for residing in another jurisdiction. Those residing outside of the area in which they are registered are considered to be "internal migrants", who are expected eventually to return to their permanent home. The economic boom in the urban areas and coastal provinces has by now drawn millions of migrants from the rural areas, and such migrant workers may apply, if the receiving jurisdiction agrees, to have their registration transferred.

[20] Inner Mongolia, Guangxi, Tibet, Ningxia, and Xinjiang.

[21] Beijing, Tianjin, Shanghai, and Chongqing.

Figure 2.1. National administrative structure



2.2.3. *Division of administrative responsibilities*

In general, the management of social insurance programmes is the responsibility of whichever is the level of administration at which the relevant enterprise has itself been registered. The relevant social security department or agency ensures that contributions are collected and that benefits are duly paid whenever the employees of a locally-registered enterprise become entitled. The majority of enterprises are registered with the county-level administrations, but some state-owned enterprises are registered with prefecture or provincial levels.[22]

Provincial level governments may either assign responsibility for collecting social security contributions to their social insurance agencies or arrange for the collection of contributions by the taxation bureaux; the arrangements put in place at the provincial level are not necessarily, however, duplicated at the level of their subsidiary jurisdictions. Social security benefit calculations and payments are the responsibility of the social security agency (or, where applicable, the employment agency).

Pension funds may be pooled at the county, prefecture or provincial level and unemployment insurance funds may be pooled at either the county or prefecture level. Funds in the other three social insurance branches, in which the level of outward payments in any given period is likely to be comparable to that of inward receipts, are held at the administrative level at which they are collected. All social insurance contributions except those for pensions are deposited in accounts maintained for the respective programme by the social insurance agency operating at the level at which the funds are pooled. Pension contributions are transferred to the finance department of the relevant government unit until needed to pay benefits. The finance department subsequently transfers to the social security agency the amount that the agency notifies periodically as being needed to cover benefit payments.[23]

The procedures to establish the boards of management of the social security agencies at each level, their staffing and operating procedures and general financial provisions are all established in accordance with the usual procedures and regulations governing public institutions. The social security agency at each level is responsible for overseeing the operations of those in the subsidiary administrative levels, but there is in fact no provision for direct control of that agency's personnel, finances or operating policies.

The operating budgets of the social security agencies are allocated from the general budget administered by the local Finance Department of each government administrative unit, and should not be drawn from the agencies' income by way of contributions.[24] Whichever administrative unit manages the relevant funding pool is also responsible for arranging finance to cover any deficits in the pension and unemployment insurance programmes, although, in this case, the administration may reasonably expect some assistance from higher levels of government. The entire cost of the Minimum Income Guarantee programme is, however, paid from general government revenues.

2.2.3.1. The Ministry of Labour and Social Security

The Ministry of Labour and Social Security (MOLSS) operates at four distinct administrative levels — national, provincial, city, and county. At the national level, the

[22] A few are also registered with the national government, although the central government apparently has delegated responsibility for dealing with enterprises registered with it to the provincial level governments.

[23] The Ministry of Finance and the Ministry of Labour and Social Security mandated the use of Finance Departments as intermediaries to hold excess pension fund balances in 1998 in an attempt to improve financial controls. The ministries are now considering extending the practice to the other social insurance branches. See "The Provisional Regulation on the Two-Way Administration of Collection and Payment of the Basic Pension Funds of the Enterprises' Staff."

[24] Contribution income was used to pay administrative expenses before 1997. The practice was discontinued in an effort to improve financial controls over administrative expenses.

role of the MOLSS lies mainly in the sphere of national policy development, but it operates functionally through delegation to the three lower levels — respectively, the provincial city, and county levels. In some cases the county level administrations have been upgraded to a level *pari passu* with the status of cities.

Within each province responsibility for the implementation of national policies within the province, and their development and interpretation in the light of local conditions, rests with the Department of Labour and Social Security (DLSS). At the City level, the Department is responsible for the implementation of the provincial government policies within the City, and the development of City policies. At the county level, the operational units are responsible for the implementation of the national, provincial and city policies.

This organizational structure for the MOLSS Departments is mirrored at each of the three operational levels; however the operational levels do not necessarily feature a full set of the more specialised higher-level institutions (such as, for example, the Labour and Social Security Newspaper Agency, or the Jiujang Training Centre). Figure 2.2, below, illustrates the overall structure.

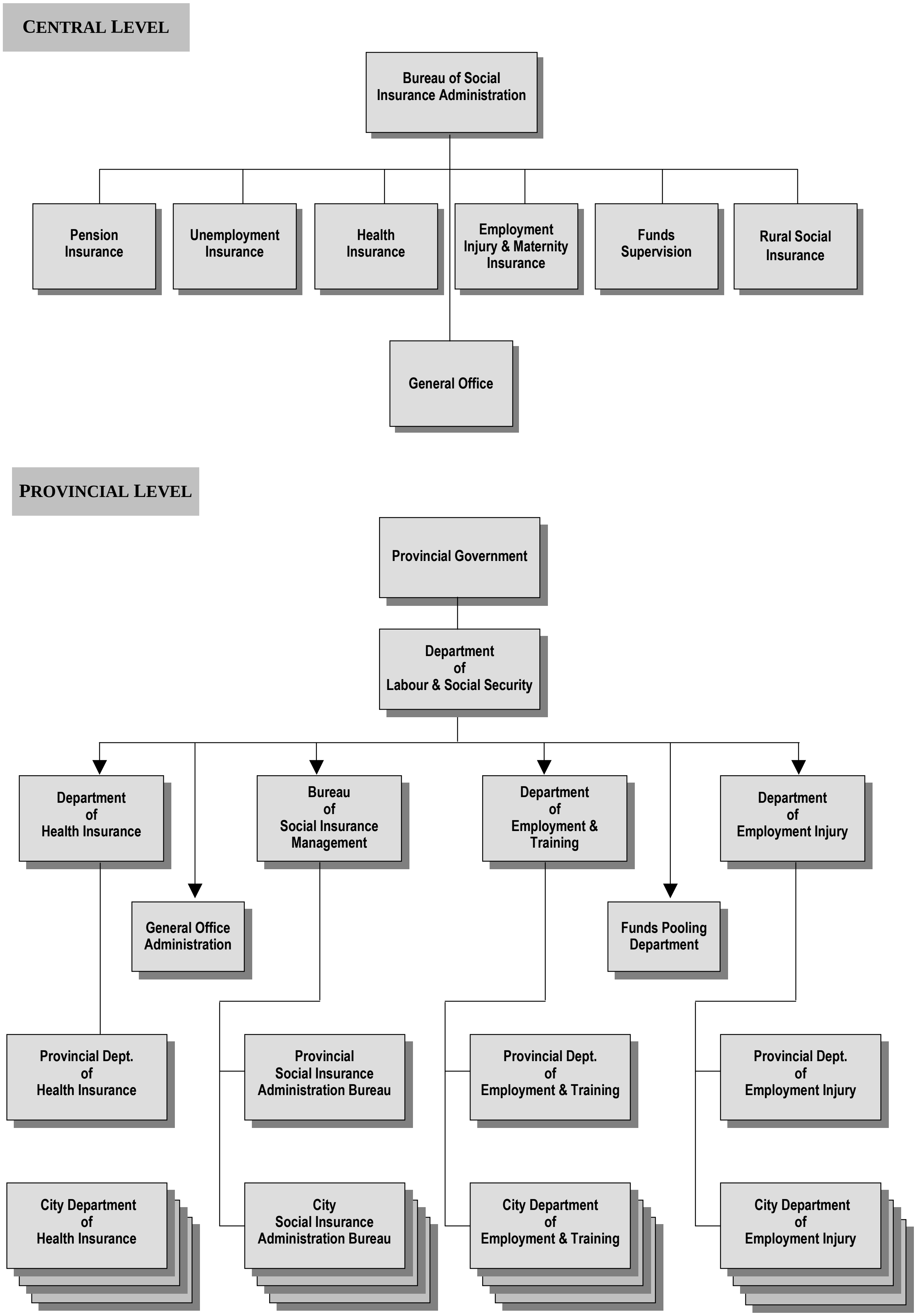
2.2.3.2. The Social Insurance Administration

The Bureau of Social Insurance Management (BSIM) operates at all three operational levels of administration, and is responsible for the implementation and day-to-day administration of the various Social Insurance schemes. At the Central level, the main role of the BSIM is to coordinate the policy development work of four departments concerned with the implementation and operations of the five social insurance schemes. At each of the subsidiary operational levels, the BSIM forms part of the government administration of that level (at the provincial level, for example, the Bureau is a provincial government Department responsible to the governor of the province; at the city/large county level the bureau reports to the mayor of the city, and so on). As a result of this structure, the BSIM at the national level exerts only indirect control over the functioning of agencies at the city and county level, whose primary affiliation is regarded as being to the appropriate local government administration. BSIM has, therefore, responsibility in a rather broad sense for overseeing the operations of these schemes:

- the pension scheme (which includes old-age pension, disability pension, survivors' pension, and supplementary pension benefits);
- the health insurance scheme;
- the employment injury insurance scheme; and
- the maternity insurance scheme.

However, in the light of the fairly early stage of development of new schemes for health, employment injury and maternity insurance (as also the unemployment scheme), and the fact that the current schemes are entirely enterprise based, the predominant present concern of the BSIM is the system of pension provision.

Figure 2.2. MOLSS Social Insurance Administration



2.2.3.3. Main functions at operational level

The main functions of the operational units at the city and county level comprise:

- registration of employers
- registration of employees
- collection and recording of employer contributions
- collection and recording of employee contributions
- processing of claims
- payment of entitlements
- compliance, and fraud prevention and detection
- accounting and audit
- financial management of the funds
- management information and statistics.

Registration

All urban state-owned and private sector entities (referred to rather loosely, for simplicity, as "enterprises") are required to participate in the social insurance schemes. They may be grouped, broadly, as:

- enterprises and "undertakings" in the public sector;
- government organizations;
- social organizations;
- not-for-profit units run by local people;
- industrial and commercial enterprises owned by individuals in cities and towns;
- state-owned enterprises (SOEs);
- collective enterprises;
- enterprises with foreign investment; and
- (corporate) private enterprises.

An enterprise must register with the appropriate social insurance agency within 30 days of receiving its business licence. The business licence has a national number, which is the key element in the social security registration process.

Units of the civil service, together with military and State-owned organizations and institutions, are exempt from the requirement to register.

Enterprise branches that are not co-located with their headquarters are regarded as independent for social security purposes, and required to register separately. Enterprises must complete the agency registration application forms and provide such documentation as their business licenses and certificates. When registered, each enterprise is issued with a "certificate of registration" by the respective social insurance agency.

An enterprise must advise the relevant social insurance agency of any changes in its registration details (including any change in name or address, change of bank account, and so on). Where an enterprise terminates its business, through, for example, bankruptcy, merger or simply closure, it must advise the agency within 30 days.

The regulations require that each enterprise must register separately for each social security scheme, thus registering with the BSIM for the pension insurance scheme, with the

Department of Unemployment for the unemployment scheme, with the Department of Health Insurance for the health insurance scheme, and with the Department of Employment Injury for the work injury and maternity insurance schemes. However, in many areas, especially where there is no computer system and manual recording on ledger cards is necessary, the burden of multiple registrations is considerable, and it is not known how fully enterprises comply with their obligations in this regard.

The employer is obliged to register each employee at the time of the employer registration. The relevant agency provides the employer with employee registration forms, which include the employee's name, national ID number, occupation, monthly wages, etc. The employer completes the forms and returns them to the agency, where they are recorded either on a computer database or manually on ledger cards. A file is maintained for each employee, recording, inter alia, his or her contribution record.

Contribution collection

Contributions are payable monthly by employers and employees. The employer is liable to pay a set percentage of the payroll for each of the social insurance schemes — the contribution rates are set at the level of the provincial administration, and differ from province to province. General rules on contribution rates are set out in Table 2.1.

Decree No. 2 of 19 March 1999 outlines the national procedures for the payment of contributions. An employer's monthly contribution is based on the payroll recorded for the previous year — this means that the employer pays a fixed amount each month for any given insurance year. As regards employee contributions, the relevant contribution amount for each of the social insurance schemes is deducted from his or her monthly wages by the employer. The deductions are not calculated on actual "take home pay", which can include various allowances, but on a wage figure which tends to vary greatly from month to month; for simplicity, therefore, the employer only advises details of those employees whose contribution amount differs significantly from that payable in the previous month (for example, where an employee has been awarded a promotion, a new employee joining the enterprise, or an employee leaving the enterprise).

Table 2.1. Social security contribution rates

Insurance Type	Employer Contribution	Employee Contribution
Old-age pension	Determined by the Provincial Governments (normally not more than 20% of payroll)	Determined by the Provincial Governments (expected not to exceed 8% of monthly wages)
Unemployment	2% of payroll	1% of monthly wages
Health insurance	Determined by the Provincial Governments (typically 6% of payroll)	Determined by the Provincial Governments (typically 2% of payroll)
Employment injury	Depends on the province and the enterprise — average about 1% of payroll	No employee contribution
Maternity	Determined by the Provincial Governments (normally not more than 1% of payroll)	No employee contribution

The employer then prepares a contributions declaration form for each of the social insurance agencies specifying, respectively, the employer's and employees' total contribution liability. The employer is required to deliver the completed form to the respective social insurance agencies by the 5th of each month, although in cases where direct delivery would be difficult, it is possible, by arrangement, to use the postal service.

Each agency then checks the declaration form for completeness and accuracy, and arranges with the enterprise for any discrepancy to be corrected. Where the form is found to be correct, it is approved and stamped, and if payment is by bank transfer the declaration form is sent to the bank as authorization for the transfer from the employer's account to the relevant social insurance agency fund account. Alternatively the employer may pay directly to the social insurance agency in cash or by cheque, which is deposited into the relevant fund account. Employers must pay the contributions within three days of their declaration forms being approved by the respective agency.

Each agency then receives a statement from the bank showing the amounts transferred from the employer accounts to the agency accounts. In provinces where the taxation agencies are responsible for the collection of contributions, the BSIM must provide the taxation agency with the contribution declaration forms advising amounts payable, and the taxation agencies in turn will advise the BSIM with details of amounts collected from each enterprise. Once this process is completed and the amounts payable have been confirmed and paid, each social security agency will update the employer and employee contribution records.

For pensions and health insurance, individual accounts are opened for each contributing employee, and are updated each month. These “accounts” do not represent actual monies available to the individual on demand, but simply his or her contribution record.

For pensions, a total of 11 per cent of wages must be allocated to the individual accounts. This is made up of the entire individual contribution, plus a sufficient amount from the employer’s contribution to bring the total to 11 per cent — if, for example, the employee is paying the maximum contribution of 8 per cent of wages, then an additional 3 per cent should be allocated from the employer’s overall contribution amount to the relevant employee’s individual account. If, after the necessary allocations have been made, any balance remains of the employer’s contribution total, this is allocated to the pooling account.

Both employers and employees have the right to enquire about their contribution payments at any time; and the BSIM is required to provide each employee with an annual statement of showing the details of accumulated amount credited to the individual’s account.

Employers are required to report each year on the payment of social security contributions to the workers’ representative conference, or to make this information available by public notice. The BSIM must also publish a report on contributions collected every six months.

Compliance

For those whose contribution payments are missed, either in full or in part, or are overdue, the BSIM prepares a statement of contributions owing, which will be presented to the employer. A daily fine of 0.2 per cent of the amount owing is applied to late payments. Where an enterprise fails to lodge the monthly declaration form, the agency can set an amount of 110 per cent of the previous month’s contribution liability as the amount due.

Inspection of enterprise records is undertaken by social security inspection agencies that are specifically responsible for the supervision of contribution payments. They are authorized to carry out inspections of company records, investigations and collection of evidence, the determination and application of penalties, and applying for hearings at the People’s Court for enforcement of penalties. This authority applies to registration requirements as well as contributions.

In addition to regular annual checks of employer records, the BSIM will provide each inspection agency with monthly information on defaulters and others where inspection is required.

2.2.3.4. Statistical reporting system

Statistical information is also generated through this decentralized administrative structure. Currently, each provincial social security office is responsible for collecting statistical data and submission to the Central level. In practice, each county office collects data from all participating enterprises in the county, completes the forms and sends summary reports to the provincial office. The provincial office then summarises the data from all local offices in the province and reports to the MOLSS.

The statistical returns are facilitated by the use of standardized, “blueprint” report forms. These can change from time to time, but in the year 2000, for example, the forms comprised 15 tables relating to social insurance (including the basic pension, health care, work injury, maternity and others), five tables concerning unemployment insurance (UI), and two tables for rural pensions. Table 2.2 outlines the general structure of these reporting forms.

Table 2.2. Statistical reporting forms on social security schemes in China
Part A: Social insurance (basic old-age, health, work injury, maternity and others)

No.	Title	Period	Unit	Submitted to	Coverage of data	Deadline
SI.1	Basic old-age insurance: Basic table (Local pooling)	Quarter Year	Province, Municipality, Autonomous region	Social Insurance Administration, MOLSS	All participating enterprises	Within 20 days of the end of the quarter. By the end of February of the next year
SI.1bis	Idem (Industry pooling)	idem	idem	idem	idem	idem
SI.2	Basic old-age insurance: Contribution collection (Local pooling)	idem	idem	idem	idem	idem
SI.2bis	Idem (Industry pooling)	idem	idem	idem	idem	idem
SI.3	Basic old-age insurance: Individual accounts (Local pooling)	Year	idem	idem	idem	By the end of February of the next year
SI.3bis	idem (Industry pooling)	idem	idem	idem	idem	idem
SI.4	Basic HI: Participants and contributions	Quarter Year	idem	idem	idem	Within 20 days of the end of the quarter By the end of February of the next year
SI.5	Basic health insurance: Contribution collection		idem	idem	idem	idem
SI.6	Basic HI: Expenditure		Year	idem	idem	By the end of February of the next year
SI.7	Social pooling fund for serious diseases and retired workers: Basic table		Quarter Year	idem	idem	Within 20 days of the end of the quarter By the end of February of the next year
SI.8	Work injury insurance: Basic table		idem	idem	idem	idem
SI.9	Work injury insurance: Statistics by industry	Year			idem	By the end of February of the next year
SI.10	Maternity insurance: Participants and contributions	Quarter Year	idem	idem	idem	Within 20 days of the end of the quarter By the end of February of the next year
SI.11	Supplementary old-age insurance and medical subsidies for civil servants	Year Half-year	idem	idem	idem	By the end of February of the next year By 20 July
SI.12	Social insurance (total): Expenditure and cost rates	Year	idem	idem	All cities and counties	By the end of February of the next year
SI.13	Social insurance agencies: Composition of staff of the social insurance agency	idem	idem	idem	Social insurance agencies	idem
SI.14	Basic old-age insurance: Pension payment for retired workers before 1949	Month	idem	idem	All participating enterprises	By the 5th of the next month
SI.15	Basic old-age insurance: participants and contributions	idem	idem	idem	idem	By the 10th of the next month

Table 2.2. Statistical reporting forms on social security schemes in China
Part B: Unemployment insurance (UI)

No.	Title	Period	Unit	Submitted to	Coverage of data	Deadline
UI.1	UI: Number of beneficiaries	Month	Social security office in Province, Municipality, Autonomous region	Department of Unemployment Insurance, MOLSS	Number and amount of unemployment benefits	Within 10 days of the end of the month
UI.2	UI: Revenue and expenditure	idem.	idem.	idem.	Unemployment division in social security office	idem.
UI.3	UI: Contribution collection	idem.	Idem (agencies in charge of contribution collection)	Department of UI; Social Insurance Administration, MOLSS	All participating enterprises	idem.
UI.4	UI: Revenue and expenditure of the pooling fund	Year	idem	Department of UI, MOLSS	Unemployment division in social security office	By 10 January of the next year
UI.5	UI: Composition of staff of the UI agency	idem	idem	idem	UI agencies	idem

Table 2.2. Statistical reporting forms on social security schemes in China
Part C: Rural pension insurance

No.	Title	Period	Unit	Submitted to	Coverage of data	Deadline
RP.1	Rural pension insurance: Basic table	Year	Province, Municipality, Autonomous region	Department of Rural Pension, MOLSS	All participating counties	By 31 January of the next year
RP.2	Rural pension insurance: Revenue and expenditure	idem.	idem.	idem.	idem.	idem.

2.3. Social insurance provisions

2.3.1. Current provisions

The current legal requirements concerning coverage are outlined in Table 2.3. Under current regulations, all five insurance branches provide coverage of all enterprises and public institutions located in urban areas. In addition, medical and maternity insurance is extended to government agencies and private non-enterprise (not-for-profit) units and employment injury insurance (EII), likewise, to non-enterprise units. Mandatory EII coverage was introduced following the introduction of the new law in January 2004. Provincial level governments may, at their option, extend coverage of Unemployment Insurance (UI) to social organizations and private non-enterprise units, and coverage under the pension, unemployment and medical insurance systems to the self-employed.[25] Annexes I to IV provide detailed information on the provisions governing the main social insurance programmes under the supervision of the MOLSS.

[25] Coverage among social organizations is limited to full-time employees.

Table 2.3. Coverage of Chinese Social Insurance Programmes
(M : Mandated by regulation; O : at option of Province)

	Pensions	Unemployment insurance	Medical insurance	Work injury	Maternity insurance
Urban enterprises					
State-owned enterprises	M	M	M	M	
Urban collective enterprises	M	M	M	M	M
Foreign & SAR funded enterprises [1]	M	M	M	M	M
Urban private enterprises	M	M	M	M	M
Other urban enterprises	M	M	M	M	M
Public institutions			M		
Government agencies			M		M
Social organizations		O	M		
Private non-enterprise units		O	M	M	M
Self-employed	O	O	O		
Flexible employment workers [2]		O	O		

1 Includes enterprises funded from Hong Kong, Macao and Taiwan.

2 Refers largely to rural migrant workers and urban informal workers.

Source: Government directives and draft legislation.

Under the regulations now covering unemployment insurance (UI), a worker who is legally resident in a rural area but is working in fact in an urban area under an employment contract is exempted from paying the employee contribution, although his or her employer is not exempt.

In 2003, the MOLSS issued two documents, “Opinions on several issues concerning part-time employment” and “Opinions guiding participation of urban labourers in flexible employment in basic medical insurance”, which pointed the way to coverage of workers engaged in “flexible” employment, the most significant group of whom are rural migrant workers.

2.3.2. Legal changes, recent and under consideration

It is evident from the foregoing that adjustments have been made to China’s social security system with some frequency, and that this process is ongoing. Much effort has gone into ensuring that the relevant laws are amended regularly. It is difficult for a survey such as this to capture the up-to-date legislative position, but it will be useful to highlight the most outstanding areas where changes have been proposed or carried out. Some additional changes are now being discussed in the context of several draft laws and regulations, but they are likely to have a smaller impact than some earlier changes. Some have already been implemented in selected provinces. Coverage will be available to workers who are legally residents of urban areas and employed in township and village enterprises (TVEs), whether the employing enterprise is located in an urban or a rural area. Meanwhile, it is recognized that certain aspects of the several basic pension programmes need attention. A draft social insurance law has been in preparation providing for the extension of general coverage under the social insurance schemes to government organisations and of mandatory coverage under the pension and UI programmes to social organisations and private non-enterprise units. Provinces will have scope, amongst the options open to them, and following the leadership of Guangdong Province (which acted in the absence of an explicit prohibition) to extend the coverage of any of the five branches of social insurance to all TVEs, whether they are located in rural areas or in urban areas, thus helping to close a gap of some significance in the regulations, which have hitherto omitted mention of TVEs. This round of changes to benefit provisions includes, finally, the authorization (on the optional, province-linked basis) of the extension of work injury protection to urban self-employed workers.

Two other adjustments will enable coverage under the various social insurance programmes to expand, as a by-product of, firstly, the revision of the area classifications to recognize that a significant number of rural regions have become urbanised in recent decades and, secondly, the redefinition of “township and/or village enterprises”. While coverage for all five forms of social insurance should in future be extended automatically to any private, collective or state-owned enterprises (SOEs) located in the region, the designation of township and village enterprises should be available only to enterprises that are located in rural areas. Hence, enterprises of this general type but located in urban areas would no longer be able to choose designation as TVEs, and so “opt out” of social insurance coverage. In combination, these two changes offer the prospect of a substantial increase in the number of workers who are employees of urban enterprises and therefore covered by the social insurance programmes on a mandatory basis.

2.3.3. Effective coverage in terms of contributors to social insurance

The number of actual contributors to the different social insurance branches in the year 2000 are shown and broken down in Tables 2.4 and 2.5. At the end of 2000, total employment giving rise to entitlement to scheme membership in urban enterprises was 129 million. An additional 63 million worked in other urban institutions and 21 million urban residents were self-employed, making a total of 213 million employed urban persons. The pension and unemployment insurance programmes each had just over 100 million contributors, with membership of the medical insurance scheme (including retirees) approaching that figure in recent years. Far fewer workers were covered by social insurance (pooling) arrangements under the work injury and maternity programmes, although workers in enterprises not covered under these two programmes should, at least in principle, have been protected under self-insured arrangements by their employers.

Table 2.4. Total number of social insurance contributors, by programme, 1990–2003
(in thousands)

	1990	1995	2000	2001	2002	2003
Old-age Pension insurance	52’007	87’378	104’473	108’019	111’288	116’465
Unemployment insurance		82’380	104’084	103’546	101’816	103’724
Basic medical insurance[1]		70’260	28’628	54’7’07	69’258	79’749
Employment injury insurance		26’148	43’503	43’453	44’056	45’748
Maternity insurance		15’002	30’016	34’551	34’882	36’554

1 Workers only, excluding retirees. In 2003, the number of insured retirees amounted to 29.268 million persons.

Source: China Labour Statistical Yearbook, 2003 (Table 11-31).

Published data provides some additional detail about those contributing to the pension, unemployment and work injury programmes, allowing a comparison of contributors to total employment by enterprise type, as shown in Table 2.5. Estimates made for the year 2001 suggest that contributors to the employment injury insurance programme constitute about 33 per cent of employees of state-owned enterprises, 45 per cent of employees of collective enterprises, and 21 per cent of employees of other enterprises. This comparison shows coverage rates for pensions and UI in excess of 95 per cent among collectively owned enterprises. Among SOEs, coverage rates are lower, at around 73 per cent for UI and 80 per cent for pensions. If the breakdown of coverage under the unemployment insurance programme is indicative of the situation in pensions also, the coverage rate for the foreign funded enterprises (for whom comparable direct figures regarding the pensions branch are unavailable) is only slightly less than that for the SOEs.[26] The residual category of "other urban enterprises" represents mostly private enterprises with domestic owners. Coverage among them under the UI programme is estimated to be less than 25 per cent and is probably only slightly higher under the pension programme.

Table 2.5. Coverage of pension, unemployment and employment injury insurance programmes, 2000
(Employment end of 2000 compared to contributors during 2000) [27]

Sector	Total Employment (x1000)	Pension		Unemployment		Work Injury	
		Contributors (x 1000)	%	Contributor s (x 1000)	%	Contributors (x 1000)	%
Enterprises							
State-owned	81,020	64,666	80	59,131	73	21,772	33
Collective-owned	14,990	14,669	98	14,454	96	6,700	45
Other enterprises	32,510	11,876	37	10,436	32	6,953	21
Foreign[1]	6,420			4,460	69	3,284	51
Other	26,090			5,976	23	3,669	14
Total, Enterprises	128,520	91,241	71	84,021	65	40,765	32
Non-enterprise	62,860	13,232	16	19,242	31	4,738	8
Total urban	212,740	104,473	49	103,263	49	43,503	20

[1] Includes enterprises funded from Hong Kong, Macao and Taiwan.

Source: China Statistical Yearbook, 2001 (employment) and China Labour Statistical Yearbook, 2001 (contributors).

Coverage rates for work injury are generally less than half of the rate for unemployment or pensions, except among the foreign funded enterprises. A part of the gap is because pools have not been set up yet in all counties, but a major reason for the gap is because enterprises have been slow in affiliating to the pools that have been set up in their localities. To the extent that the non-participating enterprises are financially sound, their employees may still have adequate coverage on a self-insurance basis, but in those non-participating enterprises with doubtful financial prospects, their employees are at risk.

Taken together then, the pension and UI programmes appear to reach roughly two-thirds of the employees of urban enterprises, even though in principle virtually all of these employees should be covered under current regulations. They reach just under one-half of the total active urban population.[28] Coverage under the work injury programme is harder to establish, but seems likely to be lower than under the pension and UI programmes.

2.3.4. *Social insurance coverage issues*

2.3.4.1. Urban workers

The major deficiencies affecting urban workers relate to the needs for coverage for the self-employed and for better enforcement of the prevailing provisions. In principle, the regulations already provide for coverage of the vast majority of urban employees. There are no exemptions (as found in some other countries) for small employers and the most recent legal proposals should deal fairly quickly with the few enterprise types not hitherto covered on a mandatory basis. Improved coverage for urban employees is primarily a matter of improving compliance with current rules rather than further changes to the rules.

[26] Foreign-owned includes enterprises owned by residents of Hong Kong, Macao and Taiwan.

[27] Total contributors may also include an unknown number of rural workers covered in TVEs in provinces that extend coverage to these enterprises.

[28] Total contributors may also include an unknown number of rural workers covered in TVEs in provinces that extend coverage to these enterprises.

Improved compliance will, however, require improvements in administrative systems, as noted earlier. The rules on coverage should be articulated clearly and communicated to employers better than they have been until now. With regard to the SOEs in particular, a degree of “political will” may be necessary if the enterprises, many of which face difficult financial conditions, are to meet their obligations in full.

Assuring adequate coverage for the self-employed is a challenge even in highly developed economies, as it is more difficult to enforce registration rules and to evaluate the accuracy of earnings declarations. For the present, it may be wise to continue the present approach that allows some provinces to test ways to extend coverage to this group without trying to implement a uniform national policy. The regulations already include a provision, designed to help to limit the loss due to inaccurate earnings declarations among the self-employed, that all workers must pay contributions calculated on earnings, whether notional or real, of an amount equal to at least 60 per cent of the average wage of the province.

2.3.4.2. Gap in coverage of employees of township and village enterprises

Township and village enterprises grew rapidly in the 1980s and continued to grow, if less rapidly, in the 1990s. They have become an important part of the economy. They are a highly diverse set of institutions, however, with wide differences in size, structure, financial condition, location, and workforce, making it difficult to find a consistent or equitable basis on which to bring their employees under social insurance coverage.

The changing composition of the TVE “sector” is illustrated in Table 2.6. Whereas twenty years ago these enterprises were primarily engaged in agricultural and industrial activities, they have now branched out into wholesale and retail trade, tourism, and a variety of other activities. By no means all of them are even located in the townships and villages that sponsor them. Their workforces include unknown numbers who have, respectively, left the land and the farming vocation, and who may have joined even though registered officially as residents of urban areas.

Table 2.6. Employment in township and village enterprises
(% distribution by industry)

Distribution of employment (%)	1980	2000
Agriculture	23	2
Industry	65	58
Construction	9	12
Transport	4	7
Trade		12
Tourism & Catering		7
Others		2
Total employment (x 1000)	**26,822**	**128,193**

A variety of proposals have been put forward over the years to improve pension coverage among TVEs, typically focusing on one of three strategies: to extend coverage under the current urban pension system to the TVEs, to create a new pension system tailored exclusively to TVEs, or to rely on a rejuvenated system of voluntary rural pensions. Of the three, expansion of the coverage under the urban system appears to offer the best prospects for success across the widest profile of provinces. In recent years, the effort to promote voluntary pension protection in rural areas appears largely to have stalled; meanwhile no concrete proposals have been put forward for creating a special system for TVEs. A particular problem with the latter approach is that the creation of a separate pension system would require the development of a mechanism for transferring credits between the TVE system and the urban pension system.

There is little reliable information on current pension coverage patterns among TVEs. Studies have found that, in some TVEs, employees are typically covered through contributions paid by the enterprises to rural pensions. In other TVEs, a proportion of employees may have been able to join the urban pension system even while others are limited to the rural system. It is clear, however, that many TVE workers are simply not covered at all.[29]

Another significant concern relates to the lack of coverage for health insurance among TVEs. In 1998, only 13 per cent of the whole rural population had any kind of health insurance coverage, and while it is likely that employees of TVEs represented a fairly large fraction of this 13 per cent (the remainder being farmers or employees of rural private enterprises), it is clear, given the low coverage for the rural population as a whole, that most TVEs lack arrangements to provide health insurance to their employees.

The size of the TVE coverage problem will be clearer as the processes of reclassification of enterprises and of urbanising areas near completion. A possible outcome, reflecting the approach contained in the most recent proposals and redrafts of the social insurance law, is that provinces will be encouraged, but not required, to extend coverage of the urban social insurance systems to the TVEs. Guangdong province has in fact already adopted this approach, in advance of formal requirements, and offers a "test bed" whose experience other provinces may be keen to study.

2.3.4.3. Absence of mandatory measures for farmers

The most critical deficiency in the social protection system for farmers in rural areas is the lack of access to health insurance. In 1976, 90 per cent of the rural population participated in some form of health insurance programme, but by 1998, that figure had fallen to 13 per cent. The decline is due largely to the disappearance of the rural collectives, which had previously been the vehicle for providing health insurance coverage. The decline in this form of coverage has left the vast majority of rural residents with no health insurance protection at all, and vulnerable to impoverishment in the event that they or their family members require any form of expensive medical treatment.

In 1991, the Ministry of Civil Affairs established on a pilot basis a system of voluntary pensions. Over the next few years, it was gradually extended to all but one of the provinces and the majority of counties in the country. Although rural residents still have this option available, it seems not to have gained widespread acceptance and, in the opinion of many commentators, may also soon begin to wither away.

At least at the national level, the system of voluntary pensions has been controversial. Its administration has been delegated to relatively low-level Government departments or relatively inexperienced staff, with the result that the scheme attracts little prestige and suffers from uneven management across provinces. Administrative costs are not met from government budgets, but through a fee levied on contribution collections, the yield of which, at least in the poorer areas may be inadequate to allow for proper management of the scheme. The programme has, however, proved relatively popular in the higher income counties, with participation rates of up to 50 per cent of eligible individuals in some parts of the country, albeit that it seems that, in some poorer areas, hardly any members have joined. Reports from some areas suggest that residents may have been coerced into participating, and raise concerns as to the quality of management, both generally and specifically in relation to the management and investment of funds. Some commentators have also pointed to the difficulty of properly advising poor rural residents as to how they should allocate their meagre resources amongst, for example, contributions to pension programmes as against health insurance schemes and meeting educational expenses for their children.

[29] Leisering, Lutz, Sen Gong and Athar Hussain, *Old-age Pensions for Rural China? Challenges and Policy Options*, Report on Small Scale Technical Assistance N° 3607, Policy Support for Social Security Reform under the *Tenth Five-Year Plan*, Asian Development Bank.

Responsibility for the rural pension programme was transferred to the Ministry of Labour and Social Security (MOLSS) in 1998. At about the same time, the State Council called for a pause in the expansion of the (voluntary) rural pension pilot while consideration was given to possible alternative modes of provision, such as commercial insurance companies. It remains to be seen to what extent commercial insurance is in fact a realistic option, particularly in the poorer areas where participation has traditionally been low and administrative resources scarce.

The Chinese voluntary pension system is unique in the world. It has promise for extending an important measure of social protection to a population that has received limited attention. However, it may be advisable to conduct a systematic review of the accomplishments and failures of the system before trying to decide whether it has future potential.

2.3.4.4. Addressing loopholes in the coverage of migrant labour

Under the current regulations, rural migrants properly employed in urban enterprises are, in principle, covered for all forms of social insurance under the same conditions as urban workers, except for UI. Under that programme, rural migrants are exempt from paying the 1 per cent employee contribution but, when unemployed, receive a lump sum payment in the nature of severance pay rather than a monthly benefit.

In practice, however, it seems likely that many rural migrants fail to gain access to the full range of their social security entitlements. In some cases, employers repeatedly withhold a labour contract that extends for the formal minimum of three months, so that an employee may remain indefinitely in a temporary status. Even if such a migrant worker does gain a permanent contract, it seems that a proportion of employers may simply ignore the relevant regulations and evade contribution payments. Rural migrants are likely to have relatively few alternatives when their employer denies them coverage. They may also have a short time horizon and are perhaps less concerned than their urban resident peers as to whether they are covered or not. In either event, the most important step to improve coverage for migrants is likely to be the same as that to improve coverage for urban workers, namely enhanced compliance.

The Labour Law of 1995 left unclear the general situation of workers in flexible employment. In the short term, pending its amendment, *ad hoc* measures may be needed to cover the gap as more and more workers are now found to be occupied in this type of employment, which is characterised by a complete lack of either a proper contract or even any clear form of labour relations between employees and employers. It is often argued that increasingly flexible forms of employment are needed to enable employers to meet the challenges of growing market demands both nationally and internationally, but the visible trends suggest also that the result is likely to be to be labour relations which are themselves increasingly irregular, volatile and unstable.

The State Council Circular of 2003 on migrant workers envisages a variety of measures which should eventually lead employers to appreciate that the advantage of employing and training Chinese migrant workers, and of providing them decent social security. The following steps were indicated:

- the elimination of intervention by the State, so as to allow the legitimate and autonomous recruitment of migrant workers;
- the abolition of the requirement for administrative approval before an employer can recruit migrant workers, and of the limitations on the type of occupations available to rural migrants moving to urban areas;
- the adoption of simplified registration measures for internal migrant workers, based on the issue of a temporary residence card in the urban locality to which a migrant worker has moved;

— the enforcement of equal treatment, free of discrimination, as between rural migrant workers and urban workers;

— the combating of corruption and the charging of administration fees.

— ensuring that wages, where specified in law, are paid as and when due to migrant workers;

— extending employment training services to rural migrants.

This programme suggests a major change to past practices of unified planning and regulation of flows of labour between the rural and urban areas, and taken together with the impact of the fairly recent change to facilitate household registration requirements, it must be expected that a period of adjustment will be need before the administration of modernised procedures can be expected to run smoothly.

2.4. The old-age pension insurance programme

Although the basic framework of what is now the current urban pension programme was established in 1997, its structure continues to evolve as the programme is gradually expanded, administrative arrangements are adjusted and new approaches are piloted in selected regions. In this section we focus on those features of the present system for which responsibility rests at the national level. A subsequent section describes the steps China has taken to introduce a measure of advance funding of pension promises.

2.4.1. Coverage and finance

As described earlier, there remain quite a number of problems to be resolved in approaching the ideal that the urban pension system should cover all employees of all urban enterprises, including state-owned enterprises, foreign-owned enterprises, and domestic privately owned enterprises. Sharper questions relate, however, to the effort to extend improved coverage to rural workers.

The effective impact of expanding the old-age pension system to the rural collective enterprises may be questionable in both the short term (if income redistribution cannot be significantly improved). This is attributable to the expected transfer of pension income from rural to urban population groups that is likely to be needed to meet benefit obligations to the relatively rapidly ageing membership of the urban population. The long-term effect may be different although for a favourable impact on rural workers, their effective participation throughout their lifetime must be achieved — usually representing a more difficult challenge than in the case of urban workers.

2.4.2. Financing

In 1995, the State Council Document no.6 introduced two alternative proposals for the financing of basic pensions. At that time, municipalities and prefectures were allowed to choose the basis to be used for their own schemes, subject to approval by the provincial level government. This led to considerable fragmentation in pension policy, and coverage which varied greatly but remained low in general, while pooling of pension resources was inadequate. “Portability” of pension rights for workers transferring between jobs was allowed and total contribution rates were high (above 30 per cent of wages in some areas). These developments were viewed with concern, not least by agencies such as the World Bank, which however provided a series of recommendations for moving towards a more rational structure of the “multiple tier” type. The system introduced comprises a basic foundation of a flat rate pension benefit related to locally prevailing average wage levels, supplemented by a further tier financed by individual accumulation accounts.[30] Preliminary actuarial calculations indicated, however, that the contribution rates prevailing in many localities would be clearly insufficient to meet the costs of financing the basic pension components. The new scheme design was introduced on a trial, pilot basis, firstly in Liaoning province in 2001, and was to be monitored with an explicit mandate to resolve at least some of these issues. At an early stage, the proportion of contributions allocated to the individual accounts was reduced to allow a larger proportion of the contribution income to be allocated to the basic pension component.

It is clearly of critical importance to arrive at a sound basis for making actuarial projections of the demographic and financial situation in future, and so to ensure the financial sustainability of the old-age pension system in the long run. It is evident that, where possible, the administrators have encouraged the accelerated registration of new members, in order that their contributions can be used to meet the current liabilities of the scheme, but this device cannot be relied upon for more than a few years, let alone indefinitely. The IMF has observed, moreover, that: "*The Central Government is in effect bailing out local pension pools, many of which are bankrupt. This trend, if unchecked, will become a threat to … fiscal sustainability…*"

The process of transferring financial responsibility for pension payments from individual enterprises to social pools is essentially complete. Pensions are now financed primarily by employer and employee contributions. The employees' contribution rate is gradually being increased and should have reached the level of 8 per cent of earnings, in all provinces, by 2005. The employers' contribution rate varies from province to province, depending on the prevailing financial condition of the programme. Typically, however, the contribution rates payable by employers tend to be around 20 per cent of earnings. Provinces wishing to set employer rates significantly above or below 20 percent should, in principle, seek the prior approval of the State Council, although it is not clear that all local jurisdictions observe this requirement at all times. Where they are covered, the contribution rates paid by the self-employed vary by province. Some provinces levy the equivalent of the combined employer and employee rate while others charge the self-employed a lower rate.

The contribution payable by an employee is levied on his or her actual earnings, including subsidies and bonuses, except that the total earnings used in the calculation of pension contributions and individual account credits cannot be less than 60 per cent or more than 300 percent of the average wage.[31] In most provinces, the employer contribution is based on the employer's total payroll. Depending on the province and the employer type, this may be the total payroll in the preceding year adjusted to reflect average wage trends or the total payroll in the preceding month.

A State Council decree provides that all pension contributions collected in a given province should be pooled at the provincial level (i.e., deposited in one central fund covering the entire province) and all benefit payments should be made from the single, pooled fund. However, only the four provincial-level municipalities and one province have consistently followed this practice. In the other provinces, the contributions collected and benefit payments have been pooled either at the level of government at which they were collected, usually the county level, or at the prefecture level, one level above the county. In 2004, over 1000 of the pension pools were still maintained at the lowest administrative level, namely that of the county. Prefecture and provincial level governments have, however, sought to balance the financial flows among the individual pools through the use of "solidarity funds", into which are paid a specific percentage of each pool's total collections, typically varying between provinces in the range of 3 to 5 per cent.

[30] For the records, it is interesting to note that the State Council adopted a contribution rate of 13 percent despite the recommendation from an international organisation to adopt only 9 per cent. The Government felt that by collecting an additional 4 percent of wages, this would cover the transition cost of the pension reform, namely associated to the reform of SOE's.

[31] The average wage for this purpose is the average in the geographic area over which pension contributions are pooled.

Where the combination of contribution income and any payments from a solidarity fund are insufficient to cover benefit costs, the governmental unit at the level at which the pool is operated must cover the shortfall from its general budget. Where funds are pooled at the provincial level, the provincial-level government is ultimately responsible for covering any shortfalls; similarly, where they are pooled at the prefecture level, the prefecture-level government is ultimately responsible. Provinces typically adopt a formula specifying the basis on which the liability to make up a shortfall will be allocated between the solidarity fund and the general government subsidies. Although most of the money used to cover pension shortfalls has thus far been supplied by the central government, lower levels of government recognize that they may face potentially considerable liabilities. The overall arrangement, in fact, represents a barrier to the implementation of provincial-level pooling, since a provincial level pool would leave the collection responsibility with lower level governments while transferring the responsibility for covering any shortfalls to the provincial government.

The scale of the present and potential difficulties is indicated by the need, in 2003 alone, for governments at all levels to contribute a total of 54.4 billion yuan from their general budgets to help finance pension payments; this represents some 20 percent of the total cost of the pension programme. Of the total, some 47.4 billion yuan (87 per cent) was paid from the budget of the central government. In 2000, 24 of the 31 provincial-level governments collected less in pension contributions than they paid in pension benefits. At present, however, there is no basis for reference to any formula for determining the level of central government assistance, and allocations have been determined administratively.

Each employee’s individual account is credited with an amount equal to 11 percent of that employee’s wage. In most cases, this means that the entire amount of an employee’s contribution is credited to his or her account, together with a share of the employer’s contribution equating to three percentage points of the relevant earnings. In all provinces except those participating in the pilot programme, the individual accounts are essentially notional, being simply records of the contributions paid and investment accumulations; the actual contributions collected are held in the pooled account and most have been used in recent years to pay benefits to current retirees. Accounts earn interest at a rate declared each year by the Ministry of Labour and Social Security; which is usually set at or close to the prevailing bank deposit interest rate.

According to current regulations, 80 per cent of any reserve funds (the excess over a two-month liquidity reserve) must be invested in government bonds. The remaining 20 per cent must be deposited with one of the four state-owned banks, namely the Industrial and Commercial Bank of China, the Agriculture Bank of China, the Bank of China and the China Construction Bank or the postal savings system. The government bonds are special instruments designed by the Ministry of Finance and carry somewhat more favourable interest rates than other government bonds. The bonds are short term, usually for a term of five years. They are not particularly liquid since there is no formal secondary market for the bonds and the central government will not redeem them prior to their maturity.

In recent years, investment returns on pension reserves have failed to keep pace with (nominal) wage growth. For this reason, amongst others, the system’s liabilities have grown faster than its reserves and workers’ wages have grown faster than their individual account balances. In the 1990s, interest rates on Chinese bank deposits were barely above the inflation rate. Between 1990 and 2000, while inflation averaged 7.9 percent, the bank deposit rate averaged 8.2 percent and the government bonds held by the pension system yielded an average of 10.2 percent. During the same period, nominal wages grew at an average annual rate of 15.9 percent. Real interest rates have risen a little since 2000 as inflation has virtually stopped and the bank deposit rate has ranged between 2.5 percent and 3 percent. However, the bank rates remain substantially below the rate of growth of average wages.

2.4.3. Eligibility

Workers must have 15 years of credits to be eligible for monthly benefits. The normal retirement age is 60 for men and women working in certain professions, 55 for female salaried workers, and 50 for other women. The retirement age is reduced by five years for those with at least 15 years of experience in hazardous occupations and for certain employees of state enterprises who lost their jobs because of the failure of their enterprises. It is also reduced by five years for women and ten years for men who are totally disabled. Workers with less than 15 years of coverage are given a lump sum equal to the locally prevailing average monthly wage multiplied by the number of years of coverage.[32]

2.4.4. Benefits

From June 1998, the retirement benefit has consisted of two parts, a basic benefit and an individual account benefit. The basic benefit is equal to 20 percent of the average wage in the year prior to the individual's retirement. The figure used in this calculation is the average for the pooling area in which the worker resides at the time of retirement. In principle, it is measured in the same way that wages are measured for calculating pension contributions.

The monthly benefit based on the individual account is the balance in the worker's account at the time of retirement divided by 120. Initial retirement benefits are to be adjusted each year by an amount established by each provincial government. The adjustment is intended to take into account changes in wage and price levels and the financial condition of the programme in the respective provinces. There is no set formula for calculating the amount of the adjustment and it need not be the same in every province.

Benefit payments from the individual account are deducted from the account when they are paid. Payments continue for as long as the worker lives. The dependents of workers who die before the account is exhausted inherit the balance in the account, while continued benefits to those who live long enough to exhaust their account balance are financed from the pooled pension fund.

Workers with earnings credits prior to July 1998 who retire after July 1998 are also entitled to a two-part transition benefit. One part is a flat amount equal to 10 percent of the average wage in the respective province during 1977. The other part is calculated by multiplying the worker's career average indexed earnings by 1.0 per cent for each year of service between ten and 15 years and by 1.2 per cent for each year of service in excess of 15 years. For this calculation, years of service include only years prior to 1998. The first of these two transition benefits adjusts for the fact that that before 1998 the flat benefit was equal to 30 percent of the provincial average wage. The second transition benefit is designed to compensate for the fact that no contributions were actually credited to individual accounts prior to 1998.

Workers who are assessed as totally disabled can qualify for retirement benefits if they have at least ten years in covered employment and are at least 50 years old, if male, or 45 years old if female. Younger workers who are totally disabled can qualify for a benefit equal to 40 percent of their previous wage, paid from the pooled pension fund. Provincial-level governments are free to decide what, if any, additional benefit may be derived from the balance in the worker's individual account, and provincial authorities are also authorized to pay benefits to survivors (generally, widows and widowers) from the pooled pension fund, but the central government has to date issued no guidelines as to how such benefits should be structured.

[32] The lump sum is based on the average wage in the jurisdiction over which pension funds are pooled.

2.4.5. *Pensions and labour mobility*

In principle, pension rights are "portable" from employer to employer and from province to province, so that an individual's retirement benefits are based on his or her full career record. In practice, benefits cannot always be transferred, nor are benefit rights always preserved. In some provinces, rural migrants are allowed to "cash out" their individual accounts when they cease working for a particular employer. Many provinces also allow rural migrants to encash their accounts to finance their obligatory home visits at the New Year Holiday.

In principle, a worker's individual account balance is transferred from the sending province to the receiving province when the worker migrates. It is not clear whether the procedures exist to enable this to happen in actual practice, and therefore how a retiring worker will be able to access the individual account accrued in a former province. It is up to the provinces to put in place their own arrangements for handling the benefit rights of migrants relating to the pooling portion of the pension. In principle, an individual worker's rights should accumulate. In practice, however, it is not clear whether rights are actually accumulated across provinces or how the responsibility for paying the resulting benefits is allocated among the provinces.

2.5. Medical insurance programme

In 1998, the State Council adopted the Basic Health Insurance System for Urban Employees (BHIS) as the approach to be implemented nationally to provide health insurance to urban workers. The BHIS programme replaced the Labour Health Insurance System for workers and dependents and the Government Health Insurance System for civil servants and public workers. Each of the previously existing programmes represented, simply, a requirement that each employer should provide access to a certain package of health services.

The implementation of the BHIS has begun in almost all of the pooling areas of the country, but is not yet complete in that many of the employers that are supposed to be covered by the new system are still operating under one of the older systems. The degree to which individuals gain membership of these the programmes simultaneously is not easy to judge. Whereas at the end of 2003, 116 million employees were participating in the pension programme, only just under 80 million were participating in the medical insurance programme. Moreover, medical insurance covers government employees whereas pensions do not.

Implementation of the BHIS has involved more than creating a new payment mechanism. It has also involved restructuring health care delivery institutions. Hospitals and clinics are to be separated from their sponsoring institutions, compete with one another for patients, and finance themselves through user charges. In the future, covered workers are to be free to seek treatment in any of the institutions participating in their jurisdiction's insurance plan. In addition, responsibility for dispensing pharmaceuticals is to be shifted from hospitals to independent pharmacies. At the time when the reform began, the typical hospital probably received about 50 percent of its revenue from the sale of pharmaceuticals and 25 percent from government subsidies. One purpose of the reform has been is to replace those two hospital income streams with income from insurance reimbursements.

2.5.1. *Coverage and eligibility*

The decree setting up the health insurance system provides that all employees, retirees and laid-off workers of urban working units should be covered. In addition to the enterprises covered by the pension programme, the medical insurance programme is also designed to cover government agencies, public institutions, party organizations and non-enterprise institutions. Only military personnel and a small number of privileged groups are specifically exempt. Provinces were to have extended coverage to the self-employed beginning in 2003 and to non-public enterprises in 2004. Provinces also have the option of extending mandatory coverage to TVEs. In principle, rural migrants working in urban enterprises are also covered, although it appears that enforcement of this requirement has been a problem in some regions.

The programme covers only workers, retirees, and the remaining laid-off workers in reemployment centres. Medical costs of those entitled to unemployment insurance benefits are financed through the unemployment programme. The programme does not cover non-working dependents of covered workers or retirees, and there is no minimum contribution period before qualifying for benefits.

2.5.2. Financing

Health insurance is financed entirely from worker and employer contributions. Contributions are collected at the level of government at which the enterprise is registered, usually the county level, and used to finance benefits for those affiliated with that governmental unit's programme. There is no provision for pooling funds at higher levels, for equalizing the burden on different counties, or for subsidies from the general budget. If local funds are insufficient, provider payments have to be curtailed.

Employees contribute two percent of their pay to the programme. The employer contribution varies from county to county and ranges from less than 6 percent in some regions to more than 9 percent in other regions. The average employer contribution rate in 2004 was 7.4 percent. Administrative expenses are financed from the general budget of the administering government.[33]

2.5.3. Benefits

The health insurance programme has two components, one being a pooled fund component and the other an individual medical account. The pooled fund component finances in-patient services at participating hospitals and the individual account can be used to finance outpatient care, related pharmaceuticals and laboratory tests. Localities have the authority to transfer some expensive outpatient services (e.g., dialysis or chemotherapy) to the social pooling portion of the programme. Inpatient reimbursements are subject to an initial annual deductible equal to 10 percent of the average annual wage in the jurisdiction managing the programme and are capped at four times the average annual wage.

All of the employee contribution and approximately 30 percent of the employer contribution is allocated to the member's individual medical account and the rest of the employer contribution is transferred to the pooled fund component. The actual split of the employer contribution is determined by the local government administering the programme and varies from locality to locality. The fraction going to individual accounts also depends on the age of the individual worker. A higher fraction goes to finance individual accounts of retired workers than of active workers, and among active workers, a higher fraction goes to finance the accounts of those over the age of 45. Retirees do not pay any contributions, but are enrolled for coverage financed from the employer contributions. Their coverage comes through the pool, which covers the locality of their permanent legal residence.

Outpatient medical providers are reimbursed on a fee-for-service basis. The prices for 3,900 medical services, pharmaceuticals, laboratory tests and medical devices are set in a national fee schedule. Local authorities are able to modify the medical service fees set nationally and to add additional items to the schedule. Balance billing is not allowed. Hospital reimbursement policies are negotiated between the various institutions and the

[33] For those workers still in reemployment centres, health insurance contributions are paid by the centre at on the basis of an assumed salary equal to 60 percent of the provincial average.

local authorities and are often some hybrid of flat-rate payments per bed day and per-case payments. Reimbursement rates vary from hospital to hospital and region to region.

2.5.4. Supplementary health insurance schemes

In order to facilitate their integration into the new system, special provisions cover civil servants and other groups whose prior coverage was more complete than that provided under the BHIS. Basically, employers of these persons are required to set up supplemental schemes that reimburse those whose health expenditures exceed the regular BHIS ceiling or whose co-payments under the BHIS exceed those under their prior coverage. These programmes are managed by the local social insurance agency, but are financed entirely by employers' contributions.

In recognition of the limits of coverage under the BHIS plan, the national government provides that employers may use up to four percent of their payrolls to provide additional health insurance coverage on a voluntary basis. Supplemental programmes can cover a portion of the deductible and annual costs in excess of the BHIS ceiling. They may or may not involve additional employee contributions in addition to the employer share and are usually underwritten by commercial insurance companies. In some provinces, the Government requires employers to provide such supplemental policies, making them essentially a second component of the health insurance package.

2.5.5. Rural health insurance

A major effort is under way to re-establish health coverage in rural areas by reinvigorating the Cooperative Health Insurance System. The major challenge is to develop a financing strategy that strikes a reasonable balance between the fiscal capacities and financial responsibilities of local governmental units and that provides a reasonable structure of contributions from individual participants. A recent moratorium on any additional taxes on the rural population, however, complicates the task. The Government has initiated pilot projects in four provinces, which are to be jointly funded by the central government and local governments together with the participants. The Government has expressed its hope to have a new system for rural residents in place by 2010, but it is too early to know how the new system will actually be structured.

2.6. Unemployment insurance programme

Unemployment insurance began in 1986 as a programme that covered only employees of state- and collectively-owned enterprises. The current benefit structure was adopted in 1993 and coverage was extended beyond the state and collective sectors in 1999.

2.6.1. Coverage

The unemployment insurance system now covers all employees of urban enterprises. Provinces have the option to extend coverage to social organizations, private non-enterprise units and the self-employed. At least one province has also extended coverage to TVEs located in both urban and rural areas. Recent legislative developments envisage extension of coverage to public institutions, but government organizations are expected to remain outside the system.

At the end of 2003, approximately 8.0 million urban workers were unemployed in China. Of these, the available figures indicate that some 4.5 million were drawing at least some unemployment insurance benefits.

2.6.2. Financing

The national directive that governs the unemployment insurance programme established an employer contribution rate of 2 percent of wages and an employee contribution rate of 1 percent. The directive also allows provincial authorities to adjust these rates to reflect the financial conditions in their programmes, subject to the approval of the State Council. Within provinces, contribution rates may vary from one county to another. At least in the more prosperous regions of the country, the rates charged are frequently less than those specified in the national directive. In principle, the employer pays contributions on behalf of all workers, but migrants with permanent addresses in rural areas are exempt from the employee contribution.

The four municipalities that have the status of provinces are required to pool their unemployment insurance contributions at the provincial level. In the other provinces, it is envisaged that funds are pooled at the prefecture level. This is in fact the practice for about half of the pools, but the other half are maintained at the county level. The pooling level may differ in different parts of a province. Where pooling occurs below the provincial level, the provinces are required to establish "solidarity funds", and all but one or two have done so. These solidarity funds operate in the same way as their counterparts in the pension area, providing resources to localities whose benefit payments exceed their contribution income. As with pensions, the governmental unit that operates the unemployment insurance pool is also responsible for covering any remaining deficits from its general budget and covers the cost of administering the programme. To date, the central government has not been called upon to help finance deficits in any component of the unemployment insurance programme.

At the end of 2002, the various provincial level governments held unemployment insurance reserves totalling 25.4 billion yuan, equivalent to about 15 months of benefit payments. Unemployment insurance payments have begun to increase in recent years as a result of the restructuring of state enterprises and the phasing out of the network of reemployment service centres.

2.6.3. Eligibility

Workers are eligible for benefits after they have worked and contributed for at least one year under the programme. As is common in unemployment programmes, benefits are available only for workers whose unemployment is involuntary, who have registered with the labour exchange, and are available for work. Eligibility ceases if the worker takes a job, refuses an offer of suitable employment, or refuses to participate in a suitable training opportunity. Workers are required to appear monthly at the employment office to prove that they continue to be available for work.

2.6.4. Benefits

The unemployment insurance programme pays cash benefits to unemployed workers, helps to finance their medical expenses, finances services they receive at labour exchanges, helps to subsidize the reemployment service centres, finances vocational training and provides payments for survivor and funeral benefits to those who die while drawing cash benefits. In 2002, cash benefits accounted for about 60 percent of total programme spending, subsidies to reemployment centres represented 18 percent of the total and payments for training and labour exchange services amounted to another 10 percent of the total.

The governmental unit that is administering the pool sets the benefit levels. The national guidelines call for unemployment benefits to be less than the minimum wage and more than the minimum living standard guarantee for the particular locality. County or prefecture-level governments also set both the minimum living standard (which is used in the administration of the minimum living guarantee) and the minimum wage. Unemployment insurance benefits are typically set at between 70 per cent and 80 per cent of the minimum wage. Although it varies from locality to locality, the minimum wage typically is around 40 percent of the locality's average wage. Unemployment benefits therefore equate to approximately 30 per cent of the locality's average wage. All unemployed workers affiliated to a particular jurisdiction's programme receive the same cash benefit.

Benefit duration depends on the length of service under the programme. Those with at least one year but less than five years of service under the programme can receive benefits for up to one year. Those with at least five years but less than ten years can receive benefits for 18 months. Those with more than ten years service can receive benefits for up to two years. Since the programme covered only workers in state- and collectively-owned enterprises until 1999, between now and 2009, only the former employees of state- and collectively-owned enterprises will be able to qualify for the full 24 months of benefits.

2.7. Maternity insurance programme

The basic provisions covering maternity insurance date from the 1951 Labour Regulations, with modifications and amendments introduced in 1988.[34] Originally, maternity benefits were self-financed by all employers. From 1988, however, some localities began to set up financial pools to socialize the fiscal burden and guarantee delivery of full benefits. Approaches to social pooling were standardized in 1994,[35] and all localities are now encouraged to transfer maternity insurance responsibilities from all of their employers to social pools. However, the transfer is not yet complete.

2.7.1. Coverage and eligibility

The maternity insurance programme covers all urban enterprises and public institutions in the sense that either they must participate in a social insurance pool that provides the prescribed maternity benefits or they must provide them on their own. Government agencies provide the benefits on their own. There is no minimum length of service required to qualify for benefits.

At the end of 2002, localities in 29 of the provincial-level units had created social pools covering maternity insurance and some 34.8 million women were insured for benefits.

2.7.2. Benefits

Benefits are available to all female employees of covered enterprises provided they are in compliance with the Marriage Law and the provisions on family planning. Benefits include: (1) wage continuation for at least 90 days at 100 percent of the previous wage, (2) medical costs associated with giving birth, and (3) any surgery costs associated with family planning.

2.7.3. Financing

Social pools to finance maternity benefits are organized primarily at the county level and financed exclusively through employer contributions. National regulations suggest an employer contribution rate of less than 1.0 percent of wages, but the actual rate will vary from one pooling region to another depending on the cost of benefits. The actual contribution rate is usually in the range of 0.6 to 0.8 percent of payroll.

[34] "The Regulation of the Labour Protection for Female Employees" issued by the State Council in 1998 and "The Instruction on Maternity Benefits for Female Employees" issued by the Ministry of Labour in September 1988.

[35] "The Temporary Administrative Regulation on the Maternity Insurance Scheme for Enterprise Workers," issued in 1994 by the Ministry of Labour.

2.8. Employment injury insurance programme

Employers have been responsible for covering medical costs and wages lost as a result of employment injuries since the 1951 Labour Regulations were issued. As with most of the other major elements of the social insurance package, this requirement has taken the form, essentially, of an employer liability until relatively recently. The movement toward social pooling of the costs began with interim regulations issued by the Ministry of Labour and Social Security in 1996. Final regulations were issued in 2003.

2.8.1. Coverage and eligibility

The Work injury programme covers all urban enterprises and public institutions in the sense that either they must participate in a social insurance pool that provides the prescribed coverage or they must finance the required benefits directly. Government agencies provide the benefits on their own. There is no minimum length of service required to qualify for benefits.

At the end of 2002, localities in all of the provincial-level units had created social pools covering employment injury insurance. Altogether, some 44.1 million workers were covered for benefits through social pooling. The balance of the urban workforce remains covered only on the basis of their employer's liability. Officials hope that the social pools will expand to cover at least 60 million in the next few years.

2.8.2. Financing

Except for the four provincial-level municipalities, employment injury programmes are operated primarily by prefecture and county level social insurance agencies and financed through pools operated at the corresponding level of government. In principle, the programmes should eventually be operated at the provincial level in all regions, but it seems unlikely that significant steps will be taken towards achieving this in the near future.

The programme is financed entirely through employer contributions. Each jurisdiction operating an employment injury pool establishes the contribution rate it estimates will be necessary to cover its costs. Pools have the authority to charge different rates to employers operating in different industries to reflect differing claims experience. Where pools are operated at the county level, it is common to have solidarity funds operated at higher levels of government to provide a form of reinsurance. Contribution rates are generally around 1.0 percent of payroll, although they may be somewhat higher for more hazardous industries and somewhat lower for less hazardous industries. Currently, variations in contribution rates are based on rough estimates of the relative cost of insuring different industries, not on the actual experience of individual employers or groups of employers.

2.8.3. Benefits

Employment injury benefits include the cost of health services, attendant fees, and such "durable medical equipment" as may be needed by a beneficiary. Both lump sum and monthly benefits are available for disabled workers and to survivors of workers whose death is linked to employment-related injuries. The amount paid is based on an assessment of the degree of disability conducted by the local Labour Assessment Commission, which is composed of representatives of the local social insurance agency, the local public health department, and the local union. Benefit levels are set by the jurisdiction that manages the pool.

2.9. Advance funding of social insurance liabilities

Recognizing the probable fiscal burden associated with the impending ageing of the Chinese population, the Government has launched two initiatives designed to increase the degree of advance funding of social insurance benefits, in particular of pensions. One involves testing an alternative benefit structure and financing strategy for the pension system and the other involves setting aside financial reserves to help cover the cost of future social insurance benefits.

2.9.1. The social Insurance pilot projects

In 2000 the State Council announced that a pilot programme would be conducted in Liaoning Province to test several improvements to the urban social security system. The pilot was subsequently extended to Heilongjiang and Jilin Provinces. All three are in the north-eastern part of China, an area that was once a centre of Chinese heavy industry operating through large, state-owned enterprises. In recent years, these enterprises have found their competitive situation increasingly difficult, many of the major enterprises have either shrunk or shut their doors, and the general economic status of the area has fallen behind that of the southeastern provinces. The region was and is seen as providing a good location to test an alternative structure for pension benefits, an alternative approach to financing pensions, and more rapid implementation of certain other social insurance initiatives.

2.9.1.1. Pension pilots

The most important elements of the Liaoning pilot programme comprise the testing of a revised approach to financing and calculating pension benefits. The balance between the social benefit and the individual account was adjusted to reduce the relative role of the individual account and increase the relative role of the social benefit, at least for longer service workers. In addition, procedural changes were introduced to help meet the cost of current pension commitments without using the funds earmarked for the individual accounts.

Under the pilot, the amount to be deposited in workers' individual accounts was reduced from 11 percent to 8 percent of contribution wages or earnings, and the employee's contribution was increased immediately to 8 percent, the level that would otherwise have been reached only some years after the pilot had begun. As a result of this change, the entire amount of the employers' contribution payments has become available to finance current pension payments, while the amount to be credited to the individual accounts has been reduced to a sum equal to the (increased) employee contribution.

An increase has been granted in the social benefit, which partially offsets the reduction in the individual account. Each year of service after 15 (the minimum for benefit eligibility) gives entitlement to an increase in a worker's basic pension benefit by an additional 0.6 percent of the applicable average wage, up to a maximum of 30 percent, or half as much again as the social benefit paid in the rest of the country. The transition benefit was also increased slightly.[36]

Of the two procedural changes introduced through the pilot programme, the first was to ensure separation of the funds derived from employees' contributions from those collected from employers. Employer contributions are credited to the appropriate city or country-level pools from which all benefits for current retirees (and most of the benefit to new retirees) are paid. Employee contributions, on the other hand, are managed at the provincial administration level to be used for no purpose other than paying future benefits from the

[36] In the pilot, the transition benefit was set at 1.2 percent of the 1997 average wage for each year of service over 10. Previously, service between 10 and 14 years earned only 1.0 percent per year. The net effect was an increase of 1 percent of the 1997 wage for anyone eligible for the transition benefit.

individual accounts. At the outset of the Liaoning pilot, the funds were invested entirely in Treasury Bonds, but a somewhat more open investment policy, through the National Social Security Fund, is envisaged for Heilongjiang and Jilin provinces.

The second procedural change introduced an explicit schedule of general budget subsidies to help cover the deficits that would otherwise have arisen in the social pooling accounts. The central government agreed to cover 75 percent of the deficit, the provincial government 5 percent, with the balance to be covered by whichever level of administration carries the responsibility for the relevant social pool.

The pilot also introduced explicit incentives for the establishment of supplementary, enterprise-based pension programmes, under the new title of “enterprise annuities.” Enterprises are allowed to fund such programmes through payroll deductions, up to the equivalent of a contribution rate of four per cent. It was expected that each provincial government would actively promote the adoption of such schemes among enterprises that could afford them, that funds would be invested advantageously in the capital markets, and that benefits would be paid on retirement in the form of annuities. A specific feature is the limitation of the expense charge for issuing an annuity to a sum equal to four per cent of the assets in an individual’s account.

2.9.1.2. Other elements

Although the changes in pension benefits were the most prominent elements, the Liaoning pilot also contained a number of other features designed to strengthen social security in the province. Several of these involved the planned implementation of decisions that had previously been taken by the State Council, notably the progressive closure of the Reemployment Service Centres and the creation of the Basic Health Insurance System.

The Provincial administration agreed to the immediate closure of all of the Reemployment Service Centres to new entrants and the immediate termination of the labour contracts of all workers being laid off in the future. The premise was that the termination of a worker’s labour contract and immediately severance of his or her link with the old employer would encourage and focus their search for new jobs. Taken together, these two changes shifted primary responsibility for the support of laid-off workers to the Unemployment Insurance programme. Between 2000 and 2002, unemployment insurance benefit payments in Liaoning province tripled.

Several additional changes were designed to cushion the impact of closing the RSCs. Firstly, workers within five years of qualifying for a pension and with at least 30 years of service were allowed to retire within their former enterprise. The enterprise would compensate them at the same rate that they would have received while in the Reemployment Service Centre while they waited to become eligible for normal pension benefits.

Units of the government administration in Liaoning also agreed that funds formerly spent on subsidizing these centres would be reallocated to improve support for laid off workers through active labour market interventions and income support delivered through the more general Minimum Living Standard Guarantee programme. Some 23 different active labour market measures were instituted, including various forms of training and employment subsidy programmes, and arrangements under which the Government would subsidise social insurance contributions for certain groups of rehired workers. Active labour market programmes were to give priority to women over age 40 and men over 50.

Those workers who exhausted their entitlements to unemployment insurance benefits were assured that income support would continue under the Minimum Living Standard Guarantee programme. Funds for that purpose were set aside in dedicated accounts to assure their availability, while programme managers ensured priority to those who had lost their jobs due to industrial restructuring. The Governments also agreed to maintain spending on all forms of social security at between 15 and 20 percent of each unit's general-purpose budget.

Under the pilot, the province agreed to devote increased attention to the implementation of the new health insurance system. Specific areas of emphasis were to include all of the province's employers yet to join the socialized system as rapidly as possible, promoting private supplementary health insurance policies among enterprises that could afford them, breaking up of local health institutional monopolies to encourage facilities to compete for all patients, and transferring the sale of prescription medicines out of the hospitals and into separate pharmacies.

Two specific changes were introduced in respect of coverage. Membership of the pension scheme was made available to the self-employed (since Liaoning had not previously exercised its option to open the scheme in this way), and the unemployment insurance scheme was extended to public institutions. Coverage of public institutions for the country as a whole under the unemployment insurance scheme had been under consideration, and the opportunity of the pilot in Liaoning was taken to undertake an initial test.

Yet further changes included adjustments in bankruptcy procedures to raise the priority accorded to payment of unpaid past wages, changes in financial management procedures to better protect social insurance contributions collected by local authorities,[37] and intensified efforts to build unified information management systems linking all of the social insurance agencies in the province.

2.9.2. National Social Security Fund

The National Social Security Fund was established in November 2000 with the primary objective of providing a mechanism for advance funding of a portion of China's social insurance liabilities and the secondary objective of promoting the development of China's capital markets. The State Council administers the Fund, while the board of management is composed of national and local government officials and other high-level political representatives.

The Fund's revenues derive from direct appropriations from the government budget, a portion of the proceeds of public sales of the shares of state enterprises and the proceeds of certain lotteries. Since its founding, Fund revenues have totalled 128.8 billion yuan (US$15.5 billion), of which three-quarters came from budget appropriations, one-sixth from the sales of SOE shares, and the remainder from lottery proceeds. The balance at the end of 2003 was 132.5 billion yuan, equivalent to 2.5 times the aggregate 2003 deficit in the national pension system.

When it was established, it was envisaged that the Fund would receive 10 percent of any SOE shares sold on financial markets. This source yielded some 12 billion yuan in 2001 and 8.8 billion in 2002. From 2003 onwards, however, the State Council exempted sales of shares on domestic markets from the requirement, in view of the depressed price levels prevailing in these markets. The remaining requirement applied only to sales in Hong Kong or abroad and generated revenues of just 0.4 billion yuan. The Fund, moreover, received no appropriation from the state budget in 2003.

It is expected, broadly, that appropriations from the national budget will resume in the future and that the State Council may at some stage authorise the resumption of the requirement that 10 per cent of the value of domestic sales of SOE shares be appropriated to the Fund. As a rough indication of the funds that might eventually be made available by this route, we may note that by the end of 2003, the continuing ownership of SOEs by the national government comprised some 189 enterprises with total assets of 4,700 billion

[37] The two-way system previously used to handle pension contributions was to be extended to all branches of social insurance.

yuan. If these were all sold at “book value”, the potential revenue for the Fund would be some 470 billion yuan. In addition, it is understood that some consideration has been given to the possibility that a similar appropriation requirement might be imposed on local governments in the event of domestic sales of their own SOE shares, but such a proposal may prove considerably more difficult to implement.

The Fund operates under the general supervision of the Ministers of Finance and of Labour and Social Security. The regulations adopted provide that at least one-half of the Fund’s assets should be held in bank deposits and treasury bonds and that no more than 40 per cent may be invested in private securities. Private securities are to be managed by external fund managers while bank deposits and treasury bonds are managed by the Fund’s internal staff. When last surveyed, the Fund had contracted six different asset management companies. These companies are not allowed to invest more than 10 per cent of the assets under their management in any single company or fund, or to own more than five percent of the outstanding securities of any single company. Management fees are capped at 1.5 percent of the portfolio being managed.

The Fund’s actual investments consist, accordingly, primarily of treasury bonds and bank deposits, which accounted for three-quarters of the portfolio at the end of 2003. Almost all of the rest of the portfolio was in equities, mostly those deposited with the fund in fulfilment of the 10 per cent appropriation requirement. The Fund held corporate bonds valued at just 600 million yuan. At present, all of the equities held by the Fund are listed either on the stock exchanges in either Shanghai or Shenzhen. The Government has recently approved investing small sums outside the country, but no foreign investments had yet been made at the time of survey.

The balance in the Fund is to be available for use in financing future social insurance expenses, but there is no explicit plan as to when and how these resources will be used. At present, decisions about any use of the Fund’s resources remain at the discretion of the Ministers of Finance and of Labour and Social Security.

2.10. Other social protection programmes

To complete this review of the existing programmes of social security, or social security-like provision, we may note the three broader programmes of social provision that are, in effect, complementary to the contributory social insurance schemes (see also Section 1.5). One is the programme of cash assistance (Minimum Living Standard Guarantee), the second is the voluntary pension programme designed originally for rural residents, and the third is the programme of support for laid-off workers through Reemployment Service Centres. As we have noted, the future prospects differ sharply among the three. While the first has been expanded recently, the future of the second is in doubt, and the third is already being phased out.

2.10.1. Minimum living standard guarantee (social assistance)

The Minimum Living Standard Guarantee is a programme of cash assistance for the poor. It began as a pilot in 1993 and gradually spread throughout the country during the later 1990s. The programme is the responsibility of the Ministry of Civil Affairs, which is also responsible for other programmes of disaster and emergency assistance to households throughout China. It is administered across the country by the civil affairs departments at the lowest levels of government administration, the districts and communes. The cost of benefit payments is shared between central and local governments. On average, the central government finances about 60 percent of the total with the balance coming from local, primarily provincial-level, government units.

The programme grew rapidly in the years from 2000 onwards. Between 2000 and 2003, the number of beneficiaries increased from 4 million to 22.5 million and central government spending rose from 0.8 billion yuan to 9.2 billion yuan. Taking into account both local government and central government spending, the total spent on cash assistance in 2003 was 15.1 billion yuan. In part, this recent growth reflects the concern of the central government regarding the impact economic restructuring was having on workers together with the additional impact of entry into the World Trade Organization, and a conscious effort on the part of the government to ensure that the programme is established firmly and operational throughout the urban areas of the country. In part it also reflects a growing need for benefits following the closure of many reemployment centres and the exhaustion of entitlement to unemployment benefits by increasing numbers of urban workers.

City and county level governments set the benefit levels under the programme. Each establishes a minimum subsistence level of income, taking into account the living standards in the area and the cost of basic necessities. In principle, the calculations reflect the local prices of a standard market basket of specified basic commodities. The level of benefits also reflects the stage of development of each individual region, however, and perhaps also the fiscal capacity of the local government.[38] Minimum subsistence levels average about 150 yuan per person per month across the country, but vary from a high of 340 yuan to a low of 75 yuan.[39] Nationally, the average benefit is 58 yuan per month and evidently falls below the respective locally-established poverty lines. However, the local civil affairs departments also distribute various forms of in-kind assistance, including food and fuel, which are not counted in these estimates of the cash payments.

The benefit actually paid is the difference between actual income of the household and the minimum guarantee, and is conditional on the household meeting all of the qualifying conditions. In addition to low income, qualifying conditions include urban residential status; eligibility and benefits are denied to applicants owning cars, jewellery, pets or other items classed as non-necessities. Benefit recipients whose condition subsequently improves, such as unemployed workers who find work, are expected to repay the assistance they have received. Eligibility determinations and benefit calculations are the responsibility of workers affiliated with local neighbourhood committees. Some provinces rely mainly on volunteers, mainly retirees, to investigate claims; others use paid employees. The responsibilities of the neighbourhood committees include periodical checks for changes in the status of recipient households that might cause a change in eligibility. The rapid expansion of the programme has, however, placed the entire administrative apparatus concerned under a great deal of stress.

All provinces except one have taken steps to expand coverage into rural areas, with the greatest effort occurring in the eight coastal provinces. The rural expansion relies exclusively on provincial government funding. Taken together, the rural programmes cover some four million additional people, although benefit levels tend to be lower than those paid in urban areas. Also, in 2004, a total of 30 local jurisdictions had started programmes to help urban workers who have exhausted their entitlement to coverage for medical care under the Basic Health Insurance System.

[38] The Development Research Center of the State Council has recommended increased oversight of the process of establishing the subsistence standards. In response, the Ministry of Civil Affairs is now reviewing the composition of the market basket used in establishing the minimum requirement and the procedures used to oversee the entire administrative process.

[39] In the relatively prosperous Guangdong Province, the 2001 minimum living standard varied from 80 to 320 yuan per month, depending on location, with an average of 215 yuan per month in the urban areas and 165 per month in the rural areas. The average pension payment that year in Guangdong was 399 yuan per month. By comparison, in the less prosperous Liaoning Province, 2001 minimum living standards varied from 156 to 221 yuan with an average of 173 yuan per month. Liaoning has not extended the programme to rural areas.

Table 2.7. Social Insurance Financial Operations, 2002
(persons in thousands, financial figures in millions of yuan)

	Contributors	Total Income	Beneficiaries	Total Expenses	Ending Balance
Old-age pension insurance	111,288	317,146	36,078	284,291	160,803
Health insurance	94,012	60,778	n.a.	40,936	45,071
Unemployment insurance	101,816	21,557	6,570	8,657	25,384
Employment injury insurance	44,056	3,203	289	1,989	8,108
Maternity Insurance	34,882	2,181	283	1,278	2,973

Source: China Labour and Statistics Yearbook, 2003.

2.10.2. Voluntary rural pensions

The Ministry of Civil Affairs launched a series of pilot programmes aimed at providing pensions in rural areas on a voluntary basis in 1992. Over the next few years, the programme spread to at least some areas within each of the provinces and coverage grew to several tens of millions of rural residents. However, enthusiasm for the programme waned in later years. In 1998, responsibility for the programme was transferred to the Ministry of Labour and Social Security and in 1999 the central government decided not to encourage further expansion of the programme pending an assessment of how best to organize and administer it. Since that time, no consensus has been reached about whether to disband the programme, transfer it in some form to the responsibility of commercial insurance companies, or resume promotion of it, and the programme has lost its earlier vigour. Figures show that new deposits have all but ceased in six or more provinces and have declined sharply in most others.

Under the programme, rural residents are provided with the opportunity to arrange to make voluntary payments into special-purpose accounts set up by their local governmental units. Local governments and township and village enterprises could also make contributions to these pensions on behalf of their citizens/employees. Account balances earn interest and participants become eligible for the payment of a pension benefit at age 60. The benefit takes the form of a life annuity of a monthly amount equal to the balance in the account at age 60 divided by 180. A guarantee was granted at the outset, providing for each worker to receive at least 120 monthly payments, with the balance paid to the worker’s survivors if the individual died before reaching age 70. A fee of around 3 percent of contributions covered the cost of administering the programme.

The government’s concern about the future of the programme involved both the adequacy of the controls over the investment of account balances and the adequacy of the benefits being provided by the programme. Under the programme, 85 percent of the funds are managed at the local (county) level. The remainder are passed to the prefecture or provincial levels, where they provide, in effect, a form of reinsurance of promised benefits. Initially, the funds were invested locally, either in local infrastructure projects or in local enterprises. However, in response to concerns (which are ongoing) expressed that these funds would be used to finance activities that involved excessive risk or poor prospects of an adequate return, and the funds might not be available when benefit were claimed, the regulations have in principle been modified to require that all funds be invested either in bank deposits or in government bonds.

At the end of 2002 there were 54.6 million accounts in total, credited with a total sum collectively of 23.3 billion yuan, suggesting an average balance across all accounts of only about 433 yuan. Just over 60 percent of the balances were in either bank deposits or government bonds, and the balance in other investments, frequently managed through locally chartered “collective trust banks.” During 2002, additional contribution income totalled some 2.5 billion yuan. About 45 per cent of the contributions came from 4.1 million individual workers and the rest from local governments or one of about 0.67 million TVEs participating in the programme. Investment income in 2002 totalled

670 million yuan and the administrative costs financed from the investment income 77 million yuan, yielding a gross return on investments of about 2.9 percent and a net return of about 2.6 percent. Pension payments during 2002 totalled 1.2 billion yuan to some 1.2 million workers. The average pensioner received just over 80 yuan per month.

Salient statistics are presented in Table 2.8.

Table 2.8. Rural voluntary pension programme

Contributors:		
Accounts with contributions in 2002		4,128,000
Total accounts open at end of 2002		54,618,000
2002 Income: (millions of yuan)		
Contributions		2,522.8
from individuals	1,154.8	
from collectives	1,368.0	
Investment income		670.3
Other income		47.6
Total income		3,240.8
2002 Beneficiaries;		
Old-age pensioners		1,234,000
Lump sum payments*		716,000
2002 Expenditures: (millions of yuan)		
Pension payments		529.9
Other benefit payments		467.4
Management fees		77.2
Other		365.0
Total		1,439.3
2002 Ending balance: (millions of yuan)		
Bank deposits		11,014.7
Bonds		3,339.7
Other financial institutions		5,747.0
Other investments		3,219.3
Total assets		23,320.8

* Survivor payments, funeral benefits, cash refunds, etc.

Source: Labour Statistical Yearbook.

2.10.3. Enterprise-based Reemployment Service Centres

The Reemployment Service Centres (RSCs) are, or more accurately were, institutions established by enterprises to ease the transition of workers laid off from state- and collectively-owned enterprises. Workers could spend up to three years affiliated to the appropriate reemployment centre, during which time they would continue to receive a monthly stipend, to be covered by the social insurance programmes, be eligible for retaining and other labour market services, and be available for rehiring by a new or restructured enterprise. The monthly stipend paid to workers in the reemployment centre was less than the wage they had received previously, but more than they would receive from unemployment insurance benefits. Workers leaving reemployment centres at the end of three years who still did not have a job would become eligible for regular unemployment insurance benefits, which, depending on the worker's tenure, could last for as much as an additional two years. Each RSC linked to a specific enterprise was financed entirely by that enterprise, if it remained profitable. If not, the centre was to be financed through equal contributions from the enterprise, the local government and the unemployment insurance programme. Local government and the unemployment insurance programme would finance the centres for bankrupt enterprises.

The reemployment service centre model was first tested in 1994, began to spread throughout the country in 1996, and was required by the State Council for all state-owned enterprises in 1998. The approach was considered a temporary expedient to help workers make the adjustment from the "iron rice bowl" system to the market economy system during a time of rapid downsizing of the state enterprises. Soon, however, officials became concerned that the support being offered by these centres was a disincentive for workers to find alternative employment and was slowing the adjustment process. In 2000, the policy was modified, following which the RSCs ceased to register new clients and began a progressive programme of closure.

Had the State Council's order been followed to the letter, the last of the centres would have closed by 2004. In fact, although the numbers are shrinking, they have not yet completely vanished. At the end of 2000, some 6.1 million workers were enrolled in the various RSCs, about twice as many as received unemployment insurance benefits. By the end of 2002, the number enrolled had fallen to 3.5 million workers, but an additional 640 thousand entered reemployment centres that year. By 2002 the number receiving unemployment insurance benefits had risen to 4.5 million.

3. The social protection development agenda

3.1. Introduction

The social security system in China is a “work in progress”. Two decades ago, it may be said to have consisted of little more than a set of policies and practices prescribed for the human resource departments of government institutions and collective enterprises. In the years since, new structures and institutions have been created, benefits have been adjusted and coverage has expanded.

However, the transformation is not yet complete. By the end of 2003, the responsibility for making pension payments, almost entirely, and for financing health benefits, largely, had been transferred to separate social insurance institutions, but many enterprises continued to pay maternity and work injury benefits directly. While coverage has in theory been expanded well beyond the state sector, actual implementation lags considerably behind. The financial burden has been broadly equalized within localities, but mechanisms for sharing risk across the country —between provinces, for example — remain inadequate. New benefit structures have been developed keeping in view the need to control the costs of the pension and heath insurance programmes, but the resulting packages may leave unwanted gaps in protection, particularly for dependants. The system still lacks a sufficiently detailed legal base and, particularly with respect to pensions, an adequate long-term financial plan.

Some current issues, such as completing the transfer of employer responsibilities for health, maternity and work injury insurance, may be resolved largely through the continuation of current implementation efforts. Others, such as the adequacy of pension and health protection, are likely to require additional analysis to assess the likely impact of current provisions and to consider alternatives in the light of social needs and fiscal capacities. Still others, such as strategies for assuring adequate protection in rural areas or for financing pension benefits in the longer term, will require the development of a clearer, national consensus than now exists about basic social and economic strategies. Finally, dealing with some current challenges may require basic changes in the structure of the network of social insurance agencies and related government institutions now serving China.

This chapter begins with some general observations about the structure of the Chinese social security system. It then focuses on specific issues that the national authorities will need to address in order to ensure that the social security system evolves to meet the needs of the rapidly developing economy. These issues are divided into three groups. First are the larger strategic choices involving the basic structure and longer-run sustainability (and affordability) of the social security system. Second are specific benefit and coverage policy issues arising in the context of the current system. Third are issues that affect benefit adequacy and sustainability but which are closely linked to the current structure of social insurance and general government institutions.

3.2. General observations

Social security programmes around the world tend to follow one of two basic structural approaches, namely contributory schemes and universal programmes. Contributory systems are financed largely through wage-related contributions paid by workers and employers and provide benefits that are available only to those who have themselves paid contributions or on whose behalf contributions have been paid. Universal programmes, on the other hand, are financed from the government’s general budget and provide benefits to all of a country’s citizens (or legal residents) that meet the relevant demographic and other qualification criteria.

China has adopted, in large measure, the contributory approach to providing social protection to its urban work force. One inherent advantage of so doing is that the social insurance contributions being collected provide directly a source of the revenue needed to finance benefits, freeing other government revenue sources for use in supporting other national priorities. Another advantage is that, while the key elements of social protection can be made available in a reliable way, the social insurance mechanism largely avoids the risk of encouraging a mindset of dependence on government largesse, since access to benefits must be earned through contribution payments. In principle, a third advantage is to be found in the introduction of a degree of fiscal discipline to the process of setting benefit levels and conditions, since any expansion of the benefit programme should in theory be balanced by corresponding increases in contribution rates. This principle is reflected fairly strongly in the health insurance programme as it has developed in China, but less so in the pension and unemployment insurance programmes, each of which enjoys certain guarantees, which are in some sense open-ended, of full benefit payment from the relevant local government authority.[40]

The contributory approach also has certain disadvantages. Most obviously, the principle of restricting benefit protection to those for whom contributions have been paid results, inevitably, in the effective denial of coverage to some portion, almost certainly amongst the poorest and most disadvantaged, of the population. Additional social protection programmes have to be created to deal with those who lack coverage under the primary programme. Restricting protection to contributors also means that the adequacy of the protection provided under the contributory programme is directly related to the effectiveness of the enforcement of the contribution obligations. Poor compliance limits coverage and undermines social protection objectives. A third limitation is that the contributory approach is not an effective strategy for providing social protection to segments of the population with limited financial capacity, since they are not likely to have the resources needed, or willingness, to finance their own benefits.

China has addressed the first of these disadvantages of the contributory approach by creating safety net programmes to help the urban population not covered by social insurance, chiefly in the form of the Minimum Living Standard Guarantee programme. It has yet to fully coordinate the parameters of the social insurance and safety net programmes; to ensure that those who have paid contributions receive some return in the form of more generous treatment than those who have not, which is an issue of particular importance in the unemployment insurance programme. The second of the disadvantages remains a challenge for China. Poor enforcement of the contribution obligation is limiting the effectiveness of the social protection programmes. China has also experienced the limits of the contributory approach in the rather mixed record of its voluntary pension programme for rural areas and will need to find creative approaches to organizing and financing health insurance for the rural population, if that is to also be structured as a contributory programme.

In developing its health and pension programmes, China has in fact chosen to combine elements of social insurance with elements of mandatory individual provision. Social insurance involves spreading risk among multiple participants, as is done with the basic portion of the pension and the in-patient component of the health care benefit scheme. Mandatory individual provision, on the other hand, involves the payment of contributions but restricting each individual's benefit to that which can be funded by the accumulation of that individual's own prior contributions. China has partially implemented the approach to pension provision through mandatory individual provision, creating individual pension accounts and individual medical payment accounts, although each retains a certain measure of cross subsidies and accordingly of social solidarity. Pensioners who outlive the average life expectancy will at some stage exhaust the assets represented by their individual pension accounts, and continuation of their pension income requires a degree of subsidy; similarly, older workers who tend to face higher than average costs of health care can

[40] Maintaining fiscal discipline does not preclude budget subsidies, but the subsidies need to be limited by a formula or other principle if a link is to be maintained between benefit generosity and contribution level.

benefit from the subsidized depositing of funds in their medical accounts greater than their own contributions would have provided.

The mixture of social insurance and mandatory individual provision raises a variety of issues and questions that must be addressed by the authorities over the next few years. What are the consequences of the rather limited capacity for risk-sharing possible through the individual medical accounts? Are the cross subsidies that provide extra resources to older workers having the intended effect? The mandatory individual pension account model is designed to provide income in retirement but is not well adapted to supporting those whose work careers are interrupted prior to reaching retirement age. Can the structure of a scheme based on mandatory individual provision be adapted to provide adequate survivor and disability protection?

China has also sought in principle to leave room for individuals to make private savings to be put towards supplementing of the mandatory pension and health insurance benefits (albeit that the mandatory rate of combined contributions for typical members of the various schemes is fairly high), and is putting in place taxation measures based on policies that encourage employer-financing of such supplements. Among the issues that will have to be addressed in this area, we may highlight the question as to how responsibilities should be divided in the future between the mandatory and supplementary programmes, and how much encouragement should be given to spread the coverage of supplementary programmes.

3.3. Strategic issues

Although the authorities have moved effectively to replace the former model of social provision for workers more or less exclusively through their employing enterprises — a model that had clearly become inconsistent with the market economy reforms — they have been less successful so far in forming a consensus with regard to certain elements of the new schemes and institutional structures needed for their operationalization. For example, there is as yet no clear vision concerning the level of government that will ultimately be responsible for operating each of the various social insurance programmes. Is there ultimately to be one national programme to cover each of the major social protection areas or 31 separate, if similar, provincial-level programmes? The financial strategy for the pension programme also needs to be clarified. Are the individual accounts to be fully funded or are they to operate as notional accounts? Are the basic benefits (and the individual accounts, if notional) to be financed on a basis which is essentially pay-as-you-go, or are they to be at least partially advance-funded? A longer-term strategy is also needed to ensure that the system remains both fiscally and socially sustainable as the population ages. Finally, in the coming decade the authorities will also need to settle on a strategy for assuring rural residents of appropriate social protection and for coordinating public social protection programmes with private supplementary programmes.

3.3.1. Degree of centralization of social insurance programmes

Settling the choice between the vision of a single national programme and that of 31 different — albeit similar — provincial programmes is a prerequisite to the building of an appropriate institutional framework. A national programme requires the construction of national databases and financial and management systems. Provincial level programmes can operate with more decentralized systems, but may require the development of explicit strategies for dealing with increasingly mobile workers, sharing programme costs, and creating a useful national system of management information. In either case, in order to create the appropriate institutions it is necessary first to know the ultimate objective.

Among the concerns to be weighed in choosing between a national and a regional approach are: (1) the level of government that is to serve as the ultimate guarantor of social protection benefits, (2) the relative importance of geographic risk (and cost) sharing and the efficacy of different approaches to sharing costs, (3) the developing pattern and frequency of workers' migration within the country and the consequences of such movements under the respective approaches, (4) the perceived level of appropriateness of geographic variation (from one province to another, for example) in benefit entitlements, and (5) variations in the technological capacity of the different geographic locations. A careful analysis of these factors may lead to the conclusion that the appropriate degree of centralization or decentralization varies amongst the different branches of social insurance.

The social insurance programmes in many countries are operated as integrated, national systems, but the fact that we can identify a substantial number of exceptions to that pattern demonstrates that other models are certainly possible. In Europe, particularly, specific industries have often developed separate pension programmes, and in several countries health insurance programmes are operated through multiple funds organized by affinity to industrial and/or geographical groupings. Canada, for example, has one pension plan that covers the province of Quebec and one that covers the rest of the country; provincial level governments operate the health insurance programmes. Technically, Germany maintains one national pension programme for white collar workers and multiple regional pension programmes for blue collar workers, while in the United States, unemployment insurance is administered by the state (provincial-level) governments.

Experience abroad shows that decentralized approaches can be an effective way of organizing social protection. Where they are used, however, they are usually accompanied by explicit strategies for ensuring the necessary coordination of entitlements and allocation of costs among jurisdictions and for narrowing cost differences among the jurisdictions.

3.3.1.1. Ultimate guarantor

Currently, the ultimate guarantor of unemployment and pension benefit payments is the Government administration (whether at the provincial or lower level) that is managing the relevant social pool, even though lower levels of government may play a role such as the collection of contributions. In such cases, the disconnection between the responsibility for guaranteeing benefits and that for collecting contributions may in fact represent a significant barrier to improved geographic pooling. Ultimately, resolving this difficulty may require that either the point of responsibility for collecting contributions (or the administrative responsibility for managing county-level employees) should be changed, or the subsidy rules should be changed to match the financial responsibility for the guarantee with the administrative responsibility for collecting contributions.

3.3.1.2. Geographic variation in programme costs

One important consideration is the degree of variation among provinces in the cost per beneficiary of providing social protection and the impact of any such variation on contribution rates. Looking at work injury benefits, in particular, and the wide spectrum of both industries and localities across the country, the benefit costs per worker can vary substantially. However, the statistics show much more homogeneity if viewed from an industry-specific perspective, and on this basis it is certainly possible to find a basis for scheme design parameters that will narrow differentials in contribution rates among localities. Similarly, while the costs of maternity insurance can vary from employer to employer, reflecting differences in the age and gender profiles of the respective workforces, there is likely to be much less "systematic" variation from one province to another. In these branches of social insurance, moreover, contribution rates, even if paid by employers only, are relatively modest, so that variations will be diluted and the impact on employer costs likely to be relatively small in the context of the total costs for the whole set of social insurance benefits.

Geographic differences in costs per employee are more likely to give rise to difficulties in the context of unemployment insurance, pensions and health insurance for retired workers, where differences in local demography can translate into substantial differences in programme costs and where differences in programme costs can have a measurable impact on average contribution rates. Such differences do appear to be significant in China. Among provincial level jurisdictions, system dependency ratios (measured here as the number of contributors supporting each beneficiary) vary widely in both the pension and unemployment insurance programmes. In the pension programme, three provinces have more than four contributors for each beneficiary while two provinces have fewer than two. If each province were left to finance its own benefits, a given contribution rate would raise three times as much per beneficiary in Guangdong as it does in, say, Shanghai. The gaps are even wider in the unemployment insurance programme, where four provinces have over 40 contributors for each beneficiary and three have fewer than ten.[41] These variations are illustrated in Charts 3.1 (relating to pensions insurance) and 3.2 (unemployment insurance).

Chart 3.1. Pension system dependency ratio, 2002

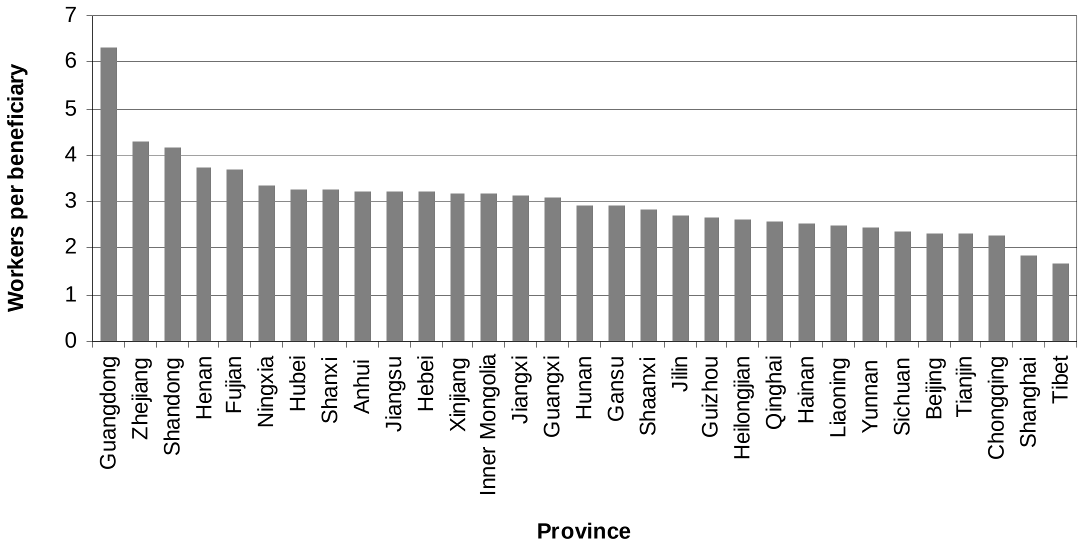
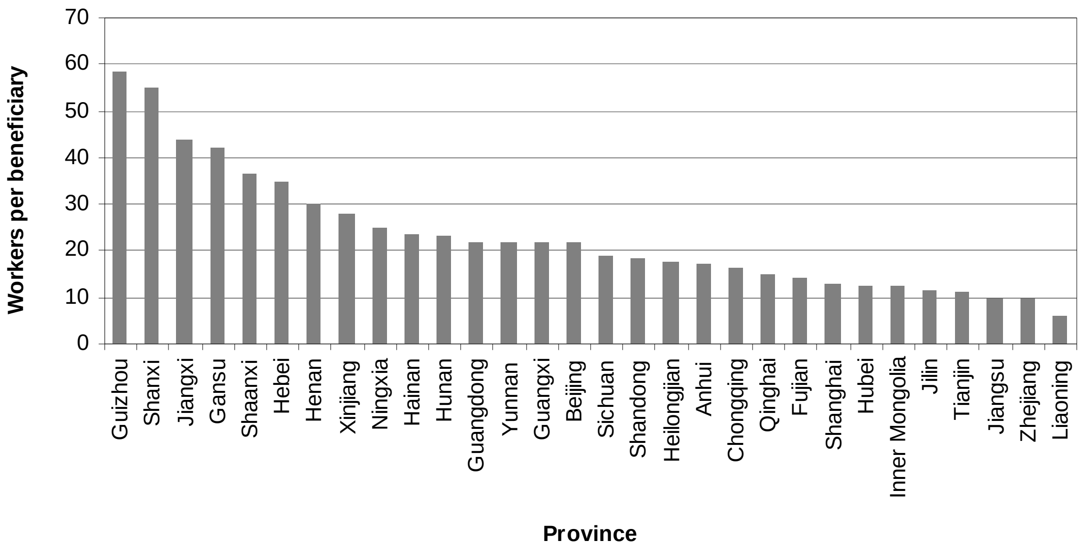


Chart 3.2. Unemployment system dependency ratios



If no measures are adopted to equalize these differences, sooner or later the contribution rates in the provinces with relatively few workers will have to be significantly increased or, at least in the case of unemployment benefits, which vary by locality, benefits must be

[41] Liaoning's ratio is depressed by the earlier closing of the reemployment centres as part of the ongoing social security pilot programme. Wider gaps in the demographic ratios of the unemployment programme do not necessarily translate into wider gaps in contribution rates since the unemployment programme is substantially smaller than the pension programme.

significantly decreased. Without a truly national system of pooling, it is possible to reduce or eliminate these differentials only by means of some direct or indirect system of transfers of assets from the provinces with more favourable to those with less favourable demographics. The gaps are sufficiently large, however, that it may be difficult politically to secure agreement between different provincial administrations to the transfers which would be required to even them out to a reasonable degree.

3.3.1.3. Mobile or “migrant” workers

In general terms, geographic mobility poses a major challenge for pension programmes, a modest challenge for unemployment insurance programmes, and little challenge at all for social insurance programmes providing maternity and work injury (or sickness) benefits. In most countries, moreover, geographic mobility poses relatively few problems in health insurance, except that differing rates of ageing may be reflected in fairly wide differences in the cost of covering retirees. Because of the particular approach it has taken, however, certain issues have become apparent relating to migrant workers in the Chinese health insurance system.

These arise in particular from differences (from one province to another) in the criteria for entitlement to benefits and the factors used to compute benefits. In most countries, entitlement to benefits in unemployment and pension schemes is established on the basis of length of working and contribution periods, which may be accumulated with different employers and in different geographic localities. In China’s schemes, pension benefit amounts and unemployment benefit (specifically the duration for which this is payable) do relate to cumulative lifetime service, but also to deposits into workers’ own accounts — an individual pension account and an individual medical account, which must, if a migrant worker is to maintain a full level of social protection entitlement be transferred to the new locality when a worker’s residence changes.

Mobility issues disappear when social protection is provided through a single national programme. Operating a single national programme requires, however, the construction and maintenance of national data systems and national financial management systems. China has signalled its intention to create such a national system for its pension programme and included some first steps to achieving this as a part of the Liaoning pilot programme. As will be discussed subsequently, there are substantial administrative barriers to achieving a truly national scheme. China has chosen, in any case, not to move to national programmes in the other branches of social insurance, at least for the time being.

Until a national system can be developed for pensions and in the absence of such a system in the unemployment and health insurance areas, China will need to create formal systems for coordinating benefits among and within provinces. It may also need to create formal institutions to supervise the coordination process and operate as clearing houses for transferring rights, responsibilities and funds among provinces or among pooling areas within provinces. One example of an issue which is technical in nature, but hard to solve in terms of practical scheme administration, and that will need to be clarified at the political level, relates to the allocation of the cost of unemployment insurance and of the basic pension benefit among pooling areas in cases where the entitlement was earned in more than one area. China may also want to use a similar allocation process to distribute the cost of health insurance for mobile retirees. A further issue concerns the rules for transferring individual pension accounts, which cannot yet be crystallized as either “notional” or “funded”, when a migrant worker moves from one province to another. If the individual accounts are to be notional (with the supporting real assets held in a collective or pooled fund), financial transfers would probably not be needed until an individual worker retired, and the rules would focus on how the cost of retirement benefits should be shared among the different jurisdictions in which the worker had been employed. If the accounts are to be funded, the entire balance in the account would probably be transferred at the time the worker changes location. Individual medical accounts raise the same set of issues.

3.3.2. Pension funding strategy

A second set of strategic issues concerns the longer-run funding strategy for the pension system. Should the system remain essentially pay-as-you-go? Should it be partially advance funded (i.e. “real” assets reserved in “trust” accounts to match accumulating liabilities)? Should the basic benefit be financed on a pay-as-you-go basis and the individual accounts be fully funded? This is an issue which is currently under discussion in China and is closely linked to the development of financial markets and their regulation on the one side, and levels of benefits and replacement income on the other.

Thus, pension funding strategies can affect the level of the contribution rate required to support a given benefit package and can serve as a catalyst for the development of financial markets. When, as in the current system in China, part of the pension package is a defined contribution individual account, the funding strategy is also likely to affect the size of the pension benefit awarded to future workers. Pension funding decisions are also, then, less likely to affect national savings rates, although that is frequently a stated motivation for advance funding, and are not likely to have an impact on the economic cost of population ageing.

It appears that it has been decided, after lengthy debate, that the basic portion of the retirement pension will be financed on a pay-as-you-go basis, but has not been decided (as yet) how the individual accounts should be financed. The current structure of the accounts seems to imply that they should be advance funded, since the investment returns credited to the accounts are linked to capital market measures (bank deposit rates) rather than labour market measures. On the other hand, outside of the Liaoning pilot area, the accounts are almost entirely notional. The design of the Liaoning pilot allows for some investigation as to what institutional and financial changes were and are necessary to achieve full advance-funding of the accounts. Under the pilot, full funding may be possible, but only on the basis of relatively large budget transfers from the national and provincial governments.

A relatively well-known principle is that advance funding of pensions will allow the financing of a given average pension benefit with a lower contribution rate if the rate of return (net of administrative and investment expenses) earned on the accumulated assets exceeds the rate of growth of aggregate wages covered by the pension programme. If the net rate of return is lower than the rate of growth of aggregate wages, advance funding requires a higher contribution rate to finance the same average benefit.[42] A corollary of this principle is that the benefit produced by an advance-funded defined contribution account will be larger than the benefit produced by a notional account only if the rate of return determined in the financial markets exceeds the wage growth rate.

From an economist’s point of view, under the circumstances in which advance funding allows (relatively) lower contribution rates, the rates are lower because the cost of providing pensions is being shared between a charge on labour (the contribution) and a charge on capital (the investment earnings). Spreading the cost in this way has the potential to reduce labour market distortions that higher contribution rates would otherwise introduce. It may also reduce political resistance to supporting the aged by reducing the cost of the more visible source of that support. In some countries, advance funding of pensions is also viewed as a valuable source of long-term funds that can help national capital markets to develop and provide needed capital for the expansion of domestic industry.[43]

Even if, with advance funding, it is possible to lower contribution rates, however, the lower rates may not result in a lower cost to society of supporting the aged population. The real economic cost of supporting the aged in a country may be measured by the fraction of that country’s national output that the aged consume. In theory, the availability of higher

[42] Aaron 1966.

[43] Thompson, 1998.

pension benefits would allow the aged to consume more, and effectively to increase the economic cost of supporting them, whereas lower pension benefits would reduce the cost of supporting the aged. How a given level of benefits is financed, however, has no direct effect on the aggregate support costs. Changing aggregate support costs requires changing either the average income of the aged (i.e. average benefit levels) or changing the age at which persons become "aged dependents" (i.e. the average effective retirement age).

At present, the returns being earned on assets held by the Chinese pension system are substantially below the rate of growth of wages. As long as this situation continues, advance funding of individual pension accounts and tying returns in those accounts to capital market measures may be seen as a disservice to future retirees. In the future, as Chinese financial markets develop, market returns should eventually rise to a level equal to or exceeding wage growth rates. At that time, it will be possible to take a more reasoned decision as to whether advance funding is likely to adequately help in developing the capital markets and whether the political and economic benefits of lower contribution rates are worth (in economic rather than social terms) the cost of accumulating pension funds.

3.3.3. Longer run sustainability

As noted in Chapter 1, the combination of low fertility and declining mortality in China will result from now onwards in an increasing "age dependency" ratio. In 2002, this ratio in the population as a whole (based on retirement rules prevailing in the urban areas pension system) was 0.23, and is likely on the basis of United Nations Population Division projections to double between 2000 and 2030 and to triple (at least) between 2000 and 2050.

In 2002, the dependency ratio in the pension system was somewhat higher than in the population as a whole, at least in part because many workers that are supposed to be covered are not, in fact, contributing.[44] If coverage improves, the demographics of the pension system will also improve, at least for a while, and can likewise be further supported temporarily by the accelerating recruitment of rural-to-urban migrant workers. Sooner or later, however, the dependency ratio in the pension system will rise to a level approximately equal to that in the population as a whole, and at that point or earlier, it will be essential to address the design parameters of the scheme, not least the current structure of retirement ages.

Estimates noted earlier (Table 1.5) showed the impact of changes in the population dependency ratio projected to 2050 of several possible changes in the retirement age. With no change in the current parameters, the 2050 aged dependency ratio would be 0.76. If the retirement age for women were increased to 60, the same as the current retirement age for men, the 2050 dependency ratio would fall to 0.56. If the retirement age for both sexes were increased to 65, the dependency ratio would fall to 0.37.

In 2002, the actual average pension was 71 percent of the average wage. If the system dependency ratio were allowed to rise to 0.76 with no change in the ratio of benefits to wages, the implicit cost of the system would rise to the equivalent of a required contribution rate of no less than 54 per cent of total wages. Even if a successful shift to partial advance funding were able eventually to mobilise capital returns sufficient to support 20 percent of the cost of benefits, the implied contribution rate would still exceed 40 per cent, which level is unlikely to be sustainable.

The effects of the 1997 reform should produce somewhat lower average replacement rates in the future, but the reduction is not likely to be enough to result in sustainable contribution rates if the current retirement age is maintained. If, for example, the average benefit dropped to 50 percent of average wages, the projected pay-as-you-go contribution

[44] See subsequent discussion of coverage. In 2002, the reported number of pension contributors was only 45 percent of estimated total urban employment.

rate would still be 38 percent. Lower contribution rates would be possible if average replacement rates were allowed to decline further. In the absence of a major expansion in supplementary programmes, it is not clear that such a reduction in effective replacement rates to below 50 percent is socially feasible, since it would sharply increase the gap between benefits for current retirees and those for future retirees. Expansion of the role of enterprise annuities would help to narrow the gap, although it implies higher costs, particularly for employers, that will offset any savings in their contributions for the basic pension system.

In summary, it must be said that it seems unlikely that it will be possible to maintain the current structure of retirement ages as China's population age profile develops. It is understandable that there is a reluctance to consider increasing the retirement age at the current time, in view of the continuing "downsizing" of the state and collective enterprises. At the same time, discussions need to be started relatively soon about the size and timing of the adjustments, of this kind and others, that will ultimately be needed to accommodate the ageing of the population.

3.3.4. Recent changes

In December 2005, the State Council Decision 38 (in addition to reiterating earlier decisions) provided for further strengthening of the basic old-age pension programme for urban workers, in the following ways:

(1) Local social insurance administrations should in future avoid the building up of pension payment arrears, and formulate plans to clear the arrears of outstanding pension payments;

(2) Effective measures should be adopted to expand coverage to urban enterprises in the private sector, including informal and self-employed workers and focusing especially on workers in small- and medium-size enterprises, allowing where necessary easements and subsidies of due contributions. The stated — and challenging — target [45] is an increase in coverage from 170 million to 220 million workers over the coming 5- year period;

(3) Individual accounts under the old-age pension insurance programme [46] should be placed on a "real" footing, i.e. supported by the actual allocation of assets, in order in particular to foster better management and investment of accumulated pension funds, and be more clearly identified from the basic pooled pension component. Two alternative approaches are suggested: either reducing the proportion of contribution income officially allocated to individual accounts or increasing the government contribution to the scheme. Of the typical contribution rate of 8 per cent of wages, the Ministry of Finance envisages that it may be possible to finance 1.25 per cent from local government budgets and 3.75 per cent centrally. Meanwhile transfers by way of subsidy to less advantaged provinces and municipalities would be limited to a much more strictly rationalised basis;

(4) Compliance should be reinforced through increasing the number of inspectors and improving procedures;

(5) More effective incentives should be provided for the participation of workers, through some modification and clarification of the pension formula, and improved transition provisions for those who participated prior to the 1997 reform;

[45] 11th Five-Year National Plan (2006–2011).

[46] According to the MOLSS, individual accounts are an integral part of the Basic Old-age Pension along with the flat-rate pension part.

(6) A regular pension indexation mechanism should be introduced, inter alia to enable pensioners to share in economic growth as reflected in (and proportionally to) the increasing average wage for active workers. This proposal may have considerable implications relating to equity, sustainability and administration;

(7) Pooling of pension resources should be improved and the management of provincial pension funds strengthened in innovative ways;

(8) Practical measures should be taken to encourage further development of occupational pensions.

3.3.5. A strategy for the rural population

The 1980s agricultural reforms laid the foundation for China’s subsequent economic boom, but were accompanied by the disappearance of its rural health system. Recent efforts have sought a new model for providing health care protection in rural areas. Pilot programmes have tested different combinations of central and local government subsidies, participant contributions, and beneficiary cost sharing, and should assist the Government in meeting its goal of having a new system in place by 2010.

There is a need, moreover for greater clarity in the strategy for dealing with the income support needs of the poor and the aged in rural areas. The approach first piloted in the early 1990s focused on the voluntary pension system, but the results have been mixed and the programme has to some extent “drifted” in recent years. An emerging alternative is based on extending the means-tested programme of the Minimum Living Standard Guarantee (MLSG) to rural areas. The MLSG seems to offer a promising approach for the rural areas as a whole, although there may well be a continuing role for the voluntary pension programme among certain segments of the rural population.

The voluntary pension programme presently comprises some 54 million open accounts spread among a rural population estimated at some 780 million in 2002, and during its history has reached a proportion of its target population which has fluctuated between 5 and 10 per cent. Less than ten percent of all accounts were active in 2002, however, and the average balance across all of the accounts is less than 500 yuan. The programme provides an important institutional vehicle for formal retirement programmes in township and village enterprises, while they remain outside the urban retirement system, with some useful capacity for promoting investments, but is likely to remain inadequate if it provides the only source of retirement income support for the majority of the rural population. Clearly, the programme is ripe for revitalization, and stronger management in the future, possibly under the auspices of the National Social Security Fund.

As in the case of the urban areas, however, a valuable role in the rural areas albeit at a lower level of benefits, may be envisaged for an extended MLSG programme. The means-tested nature of the programme will, however, set some rather unorthodox challenges including, for example, the need to value assets represented in the form of livestock and, perhaps, land tenure rights.

3.3.6. The role of the National Social Security Fund

The National Social Security Fund is currently an institution with a great deal of promise but an uncertain mission. The original objective was to capture a portion of the public resources earned through the sale of state-owned enterprises for use in helping to finance the future costs of social security. Attempts to pursue this objective seem to have encountered at least two barriers. One is a reluctance to follow the original plan of depositing ten percent of the all of the proceeds of SOE share sales in the Fund, thereby reducing its access to funds. The other is a preference for maintaining a relatively conservative investment portfolio for the Fund, thereby reducing the potential returns it can earn, which have to date been considerably less than the rate of growth of wages.

It is not clear at present how effective the Fund can be as a source of future social security financing. If all SOE shares were now sold and the Fund received ten percent of the proceeds, the estimated additional resources would amount to just under two years' pension benefit payments. While that would provide a useful cushion against future unforeseen developments, it is well short of the amount that would be needed to enable large scale restructuring of the social insurance system. In principle, additional resources might be available from the general budget, but would be competing against other important social sector demands. Even if, however, substantial additional assets were forthcoming in the near future, effective investment of them on a timely basis could not be guaranteed.

Pending, therefore, the more effective development of the Chinese financial markets the role of the National Social Security Fund may be seen in terms more of institutional development than as either a focus for investment activities or an operational solution to a future funding shortfall.

3.3.7. Calibrating the public-private mix

Current policy encourages supplementary, employer-financed pension and health insurance programmes, but many aspects of the eventual scope and operations of such programmes have yet to be defined. At present, tax deductibility for health insurance programmes is limited to 4 per cent of total wage payments and the prospective enterprise annuity arrangements are subject to the same limit. Four percent is rather a modest addition to the typical contributions now being collected for the national pension programme (about 28 per cent, employer and employee combined) but is much more substantial in relation to the amount now being allocated to basic health insurance (joint contributions of about 9.5 per cent), and suggests that it should not simply be regarded as an minor supplement to the main programme. Whether this limit is too high or too low depends ultimately on the way in which the purpose of the respective programmes emerges in the future, and the emerging costs which are to be met relating to inpatient care.

There will also be a need to assess the developing role of enterprise annuities and whether these should be more specifically targeted, for example towards enterprise managers and senior officials, amongst whom voluntary contribution capacity is likely to be relatively high and for whom the earnings cap in the pension social insurance plan results in a fairly severe limitation to the effective replacement rate which can be achieved by relatively high earners. The value of such additional annuities is currently under some question, however, as prevailing investment conditions, and regulations, mean that pricing and administration of annuities are difficult.

3.4. Specific benefit and coverage issues

3.4.1. Pensions

Several features of the current pension system raise concerns about the adequacy of benefits in general, the distribution of benefits and the allocation of the costs of benefits between the individual account and social pooling components.[47] These include the implicit interest rate that is used to calculate individual account balances, the formula used to convert account balances into monthly payments and the guarantees built into that calculation, the impact of job changes and geographic mobility on future pension benefits and gaps in survivor and disability protection. The discussion here considers, first, the operation of the system of individual accounts, followed by a more general discussion of the adequacy of benefits, in particular for workers retiring after a full career.

[47] Adequate benefits also depend on effective enforcement of coverage rules on enterprise management; that issue is discussed in a subsequent section.

3.4.1.1. Pension benefits derived from Individual Accounts

The amount of a monthly benefit representing the proceeds of an individual account is currently determined by dividing the balance in the account by 120. The pension amount may be increased from time to time in line with changes in wages and/or prices at the discretion of local authorities. If the individual pensioner dies before the account balance is exhausted (i.e. in principle, and broadly, within 10 years of retirement) the remaining balance becomes the property of any survivors, whereas if the individual lives long enough to exhaust the balance in the account, continued monthly payments are financed from the social fund.

The current arrangement raises at least three major issues: (1) whether the divisor (120) in the calculation provides at least a reasonable approximation of the benefit that the individual account system can be expected to support without a major, ongoing subsidy from the social pool account, (2) whether the use of a single divisor for people claiming benefits at different ages is likely to prove to be consistent with other aspects of Chinese pension policy, and (3) whether the guarantee of the return of the full balance in the account is appropriately reflected in the calculation of the individual account benefit. It also highlights one of the difficulties attributable to the absence of some specific details of a technical nature from the current policy guiding post-entitlement benefit adjustments.

If the individual account system is to avoid the need for any subsidies, either explicit or implicit, then the monthly payments from each individual's account must be set a level that equate the present ("actuarial") value of the expected stream of benefits with the balance in the account at the time benefits begin. The expected value of a stream of payments from an individual account is a function of the life expectancy of the account owner at the time the payments begin, the rate of return that the remaining account balance earns during the disbursement phase and the pace of adjustments over time in the monthly payment amount. The question is, therefore, whether the result of calculating benefits using the existing formula reasonably reflects the balance of these factors.[48]

Table 3.1 presents estimates of the life expectancies in China and of the appropriate account divisors associated with different life expectancies, patterns of post-entitlement benefit adjustments and rates or return earned on individual account balances. The life expectancies are those associated with the most recent median variant population projections from the United Nations Population Division. [49] Whereas the divisor now used to calculate individual account benefits implicitly assumes that the average beneficiary will live ten years after retiring, the actual life expectancy for women at ages 50 and 55 is estimated to be 26.5 and 22.1 years, respectively, and the average life expectancy for men at age 60 is estimated to be 14.6 years. If all calculations were based on combined, "unisex" life expectancies, as is these days the common practice in national pension programmes, the appropriate demographic divisors would range from 195 for benefits taken at age 60 to 291 for benefits taken at age 50. Clearly, the divisor now being used for the scheme in China is too low, even for those retiring at age 60, and technically should also vary according to the different ages at which benefits are taken.

The additional results presented in Table 3.1 illustrate the potential impact of post-entitlement benefit adjustments and investment earnings. The calculations suggest that if accounts continue to receive investment returns at the current level (2.5 per cent per annum), in more-or-less unchanged economic conditions, the appropriate divisors range

[48] The present value calculation slightly underestimates the affordable benefit when the rate of return on investments exceeds the rate of growth of benefits after retirement and slightly overestimates the affordable benefit when post-entitlement adjustments exceed the rate of return on investments. The variations arise because the distribution of lifespans is skewed.

[49] United Nations Population Division, World Population Trends, available at <www.un.org/esa/population/unpop.htm>.

from 154 to 210 assuming benefits adjust only to prices, but from 248 to 411 if benefits adjust to reflect rising wage levels.[50]

Table 3.1. Actuarially equivalent individual account divisors[1]

	Retirement age		
	Age 50	Age 55	Age 60
Sex-specific life expectancy (years) [2]	26.5	22.1	14.6
Unisex life expectancy (years)	24.3	20.1	16.3
Appropriate unisex divisor	291	241	195
Appropriate divisors with investment earnings and benefit growth:			
Investment returns = 2.5%; benefit growth = 5.0%	411	323	248
Investment returns = 2.5%; benefit growth = 0%	210	182	154
Investment returns = 5.0%; benefit growth = 5.0%	284	235	190
Investment returns = 6.5%; benefit growth = 5.0%	234	199	165

1 To equalize the account balance and the present value of the expected benefit stream.

2 Females at ages 50 and 55; males at age 60.

Source: ILO calculations. Life expectancies are from the life table implicit in the United Nations' 2002 medium variant population projections.

Very broadly, in summary, it seems that the present formula results in an implicit subsidy to the individual account owners (from, in effect the social fund) which is very large, and may be assessed as equivalent in value to 200 per cent or more of the overall amount of the individual fund (of which perhaps 50 per cent relates to increasing longevity and the remainder to failure to adjust for funding factors including cost-of-living adjustments). From an actuarial perspective, the basis for converting individual account balances into monthly benefits is far too generous.

Secondly, since the current divisor is not differentiated to reflect the greater average longevity of those first drawing benefits at relatively young ages and of women, it may be said that there is an effective subsidy of those retiring at relatively young ages by those retiring later, and of women by men. The extent to which such technical issues should be taken into account in relation to policy-making will, however, depend on the approach ultimately taken to dealing with several other issues. Their earlier retirement age gives women less opportunity to accumulate individual account balances. The use of the common divisor does help offset this disadvantage. On the other hand, the use of the constant divisor also reduces any incentive to continue working after reaching the age at which a worker first becomes eligible for benefits. Such disincentives may run counter to the direction that China wishes to take in its longer-term pension policy development.

A final issue involves the guarantee that the aggregate benefits paid in respect of each individual should be at least equal to the individual account balance at retirement, even in the event of that individual's early death. In terms of the broad concept of the individual account component of the pension system, costs are averaged according to a hypothetical life expectancy, however artificial, but in other words on the basis that payments will cease on the death of each pensioner. The guarantee of payments which may in effect continue after an individual's death, up to the amount of the individual fund does therefore impose

50 The last two rows in Table 3.1 show the divisors that would be appropriate under two alternative factual situations. The first assumes that the individual accounts were operated explicitly as notional defined contribution accounts and credited with returns equal to the rate of increase in average wages. The second assumes that the accounts eventually are able to earn a rate of return equal to 1.5 percentage points above the rate of growth of wages, which more nearly approximates the situation that might be expected after financial markets develop more fully in China. In each case, benefits are assumed to rise along with wage increases.

an additional cost which must be met by a further, albeit implicit, subsidy, presumably from the fund supporting the social component of the pension scheme.[51]

It seems likely that, because the pension insurance system is designed with two major components, both stakeholders and general observers will assume each of the two segments to be more-or-less self-financing. A closer look at the situation, and analysis as above of several important features, suggests, however, that this is by no means the case, and that the contribution assigned to the individual account portion of the benefit is likely to fall far short of what is needed to finance individual account benefits. This has several implications as regards pension policy. There is a need, which may be seen to be rather urgent, either to review the existing basis and formula for calculation of the individual account benefit, or the system needs to be re-calibrated to take realistic account of the major and ongoing effective flow of funds from the pooling accounts to the individual accounts. The result otherwise must be that the system becomes unsustainable, with the depletion, sooner rather than later, of the assets representing the social, pooled funds and ultimately a call for further subsidy of the entire system by the government treasury.

The design parameters of the voluntary pension programme operated in rural areas, are, on the other hand, considerably more robust and do not give rise to the same kind of doubts as to its sustainability. Benefits are available at age 60 and the pension amount is determined by dividing the account balance by 180 (as compared with the divisor of 120 used in the main scheme). The figures set out in Table 3.1 suggest that the formula may actually be a little too strict to give full value to an individual beneficiary if the benefits fail to be adjusted after retirement and present investment conditions continue.

3.4.1.2. Adequacy of retirement benefits for full career workers

The most important measure of success in a retirement programme is the ability to provide adequate retirement benefits at an affordable cost. Judging the adequacy of the retirement benefits that will be supplied under the current Chinese system is a complex matter, however. Most calculations of pension benefits, and any estimate of their real value, require multiple assumptions about retirement ages, years of service and wage trends. Calculating benefits derived from funded individual accounts requires additional assumptions about the rate of return that the accounts will earn and the rules to be used in converting account balances into monthly benefits streams. An assessment of the benefits to be provided in the future by the Chinese system also necessitates making an assumption as to whether and for how long the current individual account benefit algorithm will continue to be used, in the light of its apparently questionable technical sustainability.

Table 3.2 shows the results of a number of calculations of possible replacement rates for future retirees using different assumptions about individual account investment returns and the algorithm used to convert account balances into monthly benefits.[52] The data illustrate the importance of resolving some of the current ambiguities about the operations of the individual accounts before attempting to assess benefit adequacy. Under some conditions, the current system appears to be quite generous, while under other conditions benefits are rather modest.

The calculations set out in Table 3.2 focus on two hypothetical, illustrative retirees, one retiring at age 50 after 25 years of service and one retiring at age 60 after 35 years of service. The former may taken as representing typical female retirees and the latter male retirees, although these calculations are based on sex-neutral assumptions.

[51] The magnitude of such an implicit subsidy will reflect the particular pattern of investment returns and benefit adjustments. It is difficult to estimate at all precisely, but may be equivalent in value to somewhere between 5 and 15 percent of the individual fund.

[52] Replacement rates are defined here as the benefit at the beginning of a calendar year divided by the wage earned the previous calendar year.

For each illustration, calculations are shown using three different assumptions about the returns earned in the individual accounts. The first set assumes a continuation of the current pattern, where accounts grow at the rate paid on bank deposits, currently about 2.5 percent. The second is based on the assumption that the individual accounts are treated as if the system were a Notional Defined Contribution system similar to that in Sweden, with account balances earning returns at the same rate as average wages are growing.[53] The third set assumes that it is decided that the accounts should be advance funded and that, in addition, the evolution of the Chinese economy and Chinese capital markets is reflected in market returns rising to 1.5 percentage points above wage levels, roughly the gap observed in many developed countries once a conservative estimate of the costs of investment operations are deducted.

Table 3.2. **Estimated effective percentage replacement rates at age 50 and age 60, on alternative assumptions about returns to individual accounts and benefit divisors**

	Age 50 retirement			Age 60 retirement		
	Pool benefit	IA benefit	Total package	Pool benefit	IA benefit	Total package
Standard package						
Current conditions (Investment returns = 2.5%)						
1. 120 divisor	20	21	41	20	26	46
2. Actual life expectancy	20	9	29	20	11	31
Notional defined contribution (Investment returns = 5.0%)						
3. 120 divisor	20	28	48	20	39	59
4. Actual life expectancy	20	15	35	20	21	41
Improved investment returns (Investment returns = 6.5%)						
5. 120 divisor	20	33	53	20	50	70
6. Actual life expectancy	20	21	41	20	32	52
Liaoning package						
Current conditions (Investment returns = 2.5%)						
7. 120 divisor	26	15	41	30	19	49
8. Actual life expectancy	26	6	32	30	8	38
Notional defined contribution (Investment returns = 5.0%)						
9. 120 divisor	26	20	46	30	28	58
10. Actual life expectancy	26	11	37	30	23	53
Improved investment returns (Investment returns = 6.5%)						
11. 120 divisor	26	24	50	30	36	66
12. Actual life expectancy	26	16	42	30	16	46

Source: ILO's calculations based on mortality rates underlying U.N. 2002 medium variant population projections.

Two additional variations are included under each of the assumptions about the rate of returns on the individual accounts. One set of calculations converts the account balances to monthly payments using the current 120 divisor. Another set converts account balances using annuity factors that reflect actual life expectancy at the respective ages. In addition, the calculations show the effect of both the standard package now in effect throughout most of China and the revised package piloted in Liaoning province. All calculations are based on the assumption that real wages grow at a constant rate of 5 percent per year and the benefits after retirement are increased at one-half the rate of growth of real wages, or an average rate of 2.5 percent per year.

Under the standard package, all of the illustrative retirees receive a basic benefit from the social pool equal to 20 percent of prior year's earnings. Differences between the different

[53] Other countries adopting the notional defined contribution approach include Poland, Italy, Mongolia and the Kyrgyz Republic. The calculation of investment returns varies somewhat from country to country, but generally is linked either to average wage growth, aggregate wage growth, or the rate of growth of gross domestic product.

scenarios arise entirely from the differences in the value of the individual accounts. Using the 120 divisor and investment returns at approximately the current actual level (Row 1), estimated replacement rates reach just over 40 per cent at age 50 and 46 per cent at age 60. Replacement rates at that level would provide a reasonable basic income if most workers also had access to some form of supplementary individual savings or retirement benefit, but may prove to be of doubtful adequacy in the absence of other forms of retirement income. They are also substantially lower than the replacement rates typical for current retirees.

If the 120 divisor proves unsustainable (see previous section), replacement rates would be even lower. When the divisor is set to reflect realistic life expectancies, replacement rates fall to 29 and 31 per cent on retirement at age 50 and 60 respectively (Row 2). Benefits at that level are likely to create serious problems regarding retirement income adequacy in the absence of significant supplementary income sources.

Benefits would be substantially higher if the individual accounts were treated as notional defined contribution accounts and credited with investment returns at the rate of growth of average wages. Combined with the 120 divisor, that change would produce replacement rates of almost 50 per cent at age 50 and 60 per cent at age 60 (Row 3). The picture is not quite as favourable with the use of actual life expectancies to compute benefits from individual accounts, however. In that case replacement rates would range from 35 to 41 per cent at ages 50 and 60 (Row 4).

As an international benchmark, it may be noted that the level of pension benefit envisaged in the ILO's Convention N° 102 (Social Security Minimum Standards) for an individual retiring after 30 years of contributory service, is 40 per cent of his or her final level of earnings.

Eventually, China can expect that its capital markets will generate returns equal to or exceeding the prevailing rate of growth of real wages. It is likely that this would enable the system of individual accounts to generate reasonably adequate levels of income by way of retirement pensions.

This review of the structure of replacement rates under the current system suggests several observations. First, as long as the individual accounts are being credited with investment returns as low as the current rate, the current system is unlikely to produce adequate retirement benefits. Replacement rates for current workers could easily be less than half of the level experienced by current retirees.

Second, in the absence of significant supplementary retirement income sources, a system that generates replacement rates at this low level is likely to prove socially unsustainable, particularly when the benefits to current retirees are so much higher. This suggests that cost projections that assume a continuation of the current parameters may be unrealistic.

Third, a shift to an approach based explicitly on "notional defined contributions" would seem much more likely to produce adequate benefits, even without other modifications.

Fourth, the individual accounts in the current system can produce adequate benefits on the basis that they are advance-funded, provided that they can be invested in instruments that are higher-yielding than the rate of growth of average wages. The shift of assets to such instruments, assuming that they can be made available, should be undertaken as quickly as possible.

Finally, it seems likely that many future retirees will have to turn to supplemental sources of retirement income in order to be assured of a reasonably adequate relative standard of living. Steps to encourage the spread of supplemental retirement savings programme are likely to be an important part of any longer range pension strategy.

3.4.1.3. Preserving benefits of job changers

No pension system can assure adequate benefits if those who change jobs lose a portion of the earnings credits they had previously acquired or are allowed to dissipate accumulated retirement savings in the middle of their work careers. Institutional and policy weaknesses make each of these a potential threat to the retirement incomes of Chinese workers. The reforms now implemented have created institutions capable of preserving entitlements of persons changing jobs within the local labour market, but the expression of policy intent in actual administrative instructions has not to date been sufficiently definitive to resolve all of the problems in this area.

One obvious concern is the preservation for retirement of the assets accumulated in individual accounts. Some reports indicate that many rural migrants have gained approval, on a semi-official basis to withdraw their retirement savings to finance their travel home at the New Year Festival' season. Similar reports suggest also that some urban workers are allowed to withdraw their account balances when moving from one employer to another, regardless or their age and retirement status. To the extent that either of these practices occurs, the adequacy of retirement benefits is undermined. To prevent their occurrence, officials need to make it clear that individual accounts are not to be depleted prior to reaching retirement and need to take the steps necessary to enforce this policy.

More complicated issues arise when workers move from one pooling area to another or from one province to another. In principle, credits from all covered employment should be accumulated to qualify for the benefit to be paid from the social pool and each worker should be entitled to only one such benefit. In practice, however, as there are no databases that combine individual information from more than one pool, combining credits requires either that the worker supply acceptable evidence of previous coverage or that the local social insurance office in the receiving jurisdiction obtain the necessary documentation from the local office in the sending jurisdiction. There may be little incentive for staff in the receiving office to pursue this claim, however, as there are no requirements that the two jurisdictions share the cost of the resulting benefit (or providing which average wage should be used in calculating it). It seems possible also that in view of the poor level of mutual information sharing between different administrative units, a worker with at least 15 years of experience in each of two different pooling areas, and seeking to use the system to his or her own advantage, might be able to collect two base benefits.

The individual account presents an additional challenge, in particular because of the ambiguity about how such accounts are to be financed, in terms either of sharing of pooled benefit entitlements or the sharing of actual assets.

The long-term solution to many of the issues will be the creation of reliable national databases that allow central coordination of earnings credits and individual account balances, although there are certainly barriers that need to be overcome before this can be achieved. Such databases will allow central coordination of any data and fiscal issues raised by mobile workers. In the meantime, the authorities should clarify the manner in which the relevant policies regarding mobile workers are to be interpreted.

3.4.1.4. Disability and survivor protection

The current pension system provides to some degree for both survivor and disability protection, but neither benefit is well integrated with the old-age pension. Provinces are allowed to pay survivor benefits from the pooled funds, but no guidance has been supplied as to how these benefits should be structured. Survivors also inherit any balance remaining in the individual account. Totally disabled workers who are too young for early retirement are entitled to a benefit equal to 40 percent of their previous wage, paid from the social pooling account. It seems that disabled workers should similarly be entitled to receive all or a portion of the balance in their individual accounts, although no national policy has been established governing such dispositions.

Disability and survivor benefits present a particular challenge for pension systems incorporating individual accounts, whether the accounts are funded or notional. The main challenge is that disability and early death interrupt a work career and an individual's lifetime savings plan before this can be completed with the accumulation of an adequate balance in their accounts. Disabled workers are also likely to need additional and long-term income support to meet special needs.

Three strategies have evolved for integrating disability protection into individual account models. The approach used in many Latin American systems is to give disabled workers the choice between a benefit based on the balance in their individual account and a benefit based on a measure of their average wage at the onset of their disability. Those selecting the wage-based benefit forfeit their individual account and instead receive the disability benefit for the rest of their lives. Presumably, the wage-based benefit approximates the replacement rate that the pension system is designed to produce in retirement. Under this approach, most workers becoming disabled at earlier ages will be better off taking the defined benefit, whereas workers approaching retirement age may find that their individual account is more valuable. One difficulty with this approach is that developments that prevent a particular worker or group of workers from accumulating the expected individual account balance create an undesirable incentive for them to gain access to the disability rolls instead.

A second strategy, used in the Swedish system, is to pay a wage-based benefit to disabled workers during the years between disability onset and eligibility for retirement benefits while continuing to add credits to the individual retirement account. Once the worker reaches retirement age, the disability benefit ends and the worker transfers to the retirement programme. The cost of the additional credits to the workers individual account is simply an explicit recognition of the cost of supporting disabled workers throughout their retirement years. One difficulty with this approach is that the level of income support received by the worker may change unpredictably when the worker reaches retirement age since retirement and disability benefits would rarely be of equal size. Where the individual accounts are advance funded, the approach will also require the social insurance agency to find the funds needed to continue to make deposits into the disabled workers' retirement accounts while they are simultaneously financing the disability benefits.

A third approach is to calculate a disability benefit based on the average earnings level of the disabled worker and pay that benefit (or the appropriate portion of it after deducting a social pooling entitlement) from the individual account. The result is similar to that outlined in the first approach except that, instead of in effect "confiscating" the individual account, the social insurance agency adds enough to the account to produce the desired benefit. Presumably, this approach has the same potential for creating undesirable incentives (to gain specific disability benefits) as does the first approach.

The appropriate approach to survivor protection in China probably depends on the patterns of mortality amongst workers. Conceptually, protection for the survivors of workers dying before reaching retirement age involves the same kind of issues that are raised by disability prior to retirement and can be handled using the same principles. A schedule of benefits would be established for the survivors of such workers, and a portion of each benefit paid from the social pooling fund. To the extent that the deceased worker's individual account lacks sufficient funds to finance the remaining benefit, the account would be supplemented using one of the three approaches just outlined.

The situation is different for the survivors of workers dying after reaching retirement age. In this case, the worker has had the full opportunity to accumulate funds for a retirement pension in the individual account. Whereas in the disability and young survivor cases, the challenge was to finance benefits when the retirement savings plan was only partially completed, in this case the challenge is the proper apportionment of the available balance. Several approaches are possible, depending on the social principles that the authorities wish to adopt. Some countries offer only income-tested benefits for older survivors, assuming the most aged survivors will themselves be retired workers and recipients of their own pensions. Some countries offer periodic payments from the social pool but offset them partially or fully for any pension that the survivor receives as a former worker. Where a part of a worker's retirement benefit is based on an individual account balance, a third possibility is to require workers that have dependent spouses or children to accept a lower initial benefit in return for the additional protection of survivor coverage for their dependents.

3.4.1.5. Institutional issues relevant to pensions

We note here, in brief, that several additional issues stand to be addressed which are closely linked to the current structure of the social insurance institutions. They include problems in gaining compliance with the coverage rules, the challenges that come from having inadequate information and financial management systems, and the need for improved actuarial and analytical capacities.

3.4.2. Health insurance

Over the next few years, the two most important activities will be to complete the implementation of the urban basic health insurance system and to test alternative ways of extending health coverage to the rural population. At the same time, authorities should also be analysing experience under the new urban system to assess the adequacy of the structure, scope and coverage of its benefits. Both the structure and the parameters of the new system appear at this stage to be somewhat arbitrary in nature. Whether this particular structure provides a reasonable balance among competing considerations of programme cost, programme impact and benefit adequacy must be established on the basis of the actual impact on programme beneficiaries.

One concern about the current structure is the impact of the reimbursement limits in the pooling portion and the cap on spending that can be financed from the individual account. What fraction of beneficiaries exhausts their entitlement in a given year and by how much do they exceed the ceiling? What resources are they using to cover the excess costs? How does the distribution of such beneficiaries compare to the distribution of the entire insured population? Does the current age-adjusted structure of the deposits into the individual accounts appear to track relative needs?

Another concern is the structure of supplementary health insurance benefits. How many enterprises have decided to offer supplementary benefits and, based on the experience thus far, what level of such provision might one expect in the longer run? To what extent are the supplementary policies filling the deductibles and covering expenditures in excess of the limits and to what extent are they covering items not covered at all under the basic health insurance? What role might a government programme to subsidize the cost of the few very expensive medical cases play in encouraging enterprises to provide supplementary coverage? What role might there be for local governments to help subsidize such coverage?

A third area of concern is the absence of dependants' health insurance benefits. What impact does this appear to have on the delivery of basic health services to children? How many adults are actually left uncovered as a result of this policy?

A fourth set of issues concern the effectiveness of the cost containment strategies used in the two parts of the health insurance package. Are local authorities able to negotiate reimbursement packages that restrain total hospital spending? When the same local governments own hospitals, do the results of the negotiations differ? Is there evidence that the individual account approach reduces the consumption of outpatient services and, if so, are the reductions in areas where prior patterns might have involved excessive consumption?

Questions of this kind are challenging, and the answers are likely to emerge only gradually from studies of, for example, the administrative data generated in the reimbursement process. The issues will probably require some special studies focusing on spending patterns among population samples.

3.4.3. Unemployment insurance

3.4.3.1. General financial trends of UI

Demands on the unemployment insurance programme have increased in recent years as the restructuring of the state enterprises led to major increases in the number of beneficiaries. The benefit rolls tripled over the four years between 1998 and 2002, perhaps approaching 5 million or more during 2002–03. Officials expect that entry into the World Trade Organization and the closing of the Reemployment Service Centres will put further pressure on the programme, but little work has been completed as yet to project the likely impact of these changes and asses the adequacy of the current financing arrangements.

Although the year-end accounting balances in the various unemployment insurance accounts have continued to grow in recent years, there seem to be some indications that the underlying financial condition of the programme may be deteriorating. In 2000, total contribution income across the country exceeded ongoing programme costs (total costs less the cost of subsidies to the reemployment centres) by 3.2 billion yuan. By 2002, contribution income nationally was 1.1 billion less than ongoing programme costs. Of the 31 provincial-level governments, 14 were in deficit on this measure in 2002 and their aggregate deficit amounted to 3.9 billion yuan. Much of that gap, plus 3.2 billion yuan paid in subsidy to the reemployment centres, was covered through transfers from provincial and local governments.

3.4.3.2. UI benefit levels

Unemployment insurance benefit levels are rather low. Benefits are set at 70 to 80 per cent of the minimum wage in each city. As the minimum wage is some 40 per cent of the average wage, the resulting unemployment benefit amounts only to some 30 per cent of the average wage. This is only about two-thirds of the benefit level contemplated in ILO Convention 102, which suggests a minimum benefit rate of 50 per cent of the average wage for skilled workers.

Unemployment benefits are sufficiently low that in many locations, a household with two or three members that had only unemployment insurance for support would be eligible for a supplement from the minimum income guarantee programme. This situation raises questions about the adequacy of the basic unemployment insurance protection. What is the purpose of running a contributory social insurance programme if the benefits provided are little more than is provided by the general social assistance programme?

3.4.3.3. UI benefit duration

Though monthly benefits are low, many workers remain eligible for unemployment insurance benefits for a long period of time. Workers who have been under the system for at least 10 years can draw benefits for up to 24 months, four times the minimum period envisaged in Convention 102.

Unemployment insurance is usually thought of as a short-term benefit programme designed to insure workers against the loss of income due to “frictional” spells of unemployment. It is not usually an adequate tool for dealing with major structural unemployment problems. Extended periods of eligibility for unemployment benefits may be justified where general economic conditions are poor or where the characteristics of a particular worker, such as age and skill level, make finding alternative employment more difficult. The length of entitlement to benefits in the Chinese unemployment insurance programme is not related to either of these attributes, however.

The country's unemployment regulations restrict access to longer-term unemployment benefits to those who have been covered by the programme for five or ten years. As a practical matter, this means that the only workers who are entitled to benefits for more than 12 months are workers who are laid off from the state-owned enterprises. The long-duration unemployment insurance benefits therefore have aspects of serving as a substitute for severance payments for workers leaving this one kind of enterprise. As such, questions can be raised about the appropriateness of their being financed by a payroll tax levied on all enterprises and about the wisdom of tying the receipt of the severance pay to a condition that the worker actually spends two years unemployed.

It was decided to close the network of Reemployment Service Centres when evidence emerged that providing too attractive a cushion hindered the adjustment process. Unemployment insurance benefits are less generous than the payments from the Reemployment Service Centres, but for former SOE employees they continue long enough that they may themselves also become a deterrent to labour market adjustment. At least this is an area that deserves further study.

3.4.3.4. Financial planning under the UI programme

Apparently there is little ongoing research at present as to further projected demands on the unemployment insurance and employment service systems. Officials in the central government expect a sharp increase in the number of unemployed workers as a result of China's entry into World Trade Organisation and the closing of the Reemployment Service Centres. Few systematic projections of future costs among provincial or local authorities are, however, available.

Continued increases in the number of unemployed workers will cause serious fiscal problems for many local governments, who will see increasing operating budgets of their social insurance and employment service agencies and may face additional liabilities to cover contribution revenue shortfalls. Provincial level officials probably need to devote more attention to carefully reviewing the economic situation, projecting the medium term impacts on the unemployment insurance programmes within their jurisdiction, and communicating their results to city and county level officials.

3.5. Social insurance institutional issues

Several important issues facing the Chinese social security system are closely related to the system's current administrative arrangements. Addressing the problems arising in these areas will probably require the development of alternative administrative processes and structures. The issues include gaps in the actual coverage of the current system, shortcomings in information and financial management systems, and limitations in the capacity to analyse current operations and project future obligations.

3.5.1. Compliance and coverage

In principle, most urban enterprises and most urban workers should now be covered by the social insurance systems. In practice, large gaps exist in the statistics as between the estimated number of workers employed in the various types of enterprises and the number reported to be contributing to the various social insurance branches.

3.5.1.1. Estimated compliance rates

The most recent statistics of which account can be taken here, on contributors broken down by industry segment, apply to the situation at the end of 2000 and are summarized in Table 3.3 That year, the total number of workers reported to be making contributions to the pension programme represented 49 per cent of total reported urban employment. Contributors to unemployment insurance also numbered 49 per cent of the total, while contributors to work injury and maternity insurance formed only 20 and 14 per cent of the total. Contributors to the new health insurance system were even lower, but implementation of the programme was embryonic at that time.

Table 3.3. **Ratio of employees to social insurance contributors, end of 2000**

	Total employment (millions)	**Percentage of employees contributing to:**				
		Pension	**Health**	**Unemployment**	**Work injury**	**Maternity**
State-owned enterprises	81.02	80%		73%	33%	
Collective-owned enterprises	14.99	98%		96%	45%	
Other	32.51	37%		32%	21%	
Subtotal: Enterprises	128.52	71%		65%	32%	
Urban non-enterprise	84.22	16%		23%	3%	
Total urban	212.74	49%	9%	49%	20%	14%

Source: China Labour Statistical Yearbook, 2001.

Although not all urban employees are covered by the pension, unemployment and work injury programmes, all of the employees of "urban enterprises" are supposed to be so covered. The ratio of contributors to employment for this segment of employment may therefore provide a better indicator of the extent of coverage. The data (see Table 3.4) suggest that only about 70 per cent of the employees of urban enterprises were contributing to pensions at the end of 2002, only 65 per cent were contributing to unemployment insurance and only about one-third were contributing to the work injury programme. The lowest contributor ratios are found among "other" enterprises, which are primarily private and foreign-funded enterprises, where pension contributors represent just over one-third of estimated total employment and even fewer contribute to the other two programmes. Even the state-owned enterprises exhibit serious gaps in coverage.

Table 3.4. **Trends in urban employment and social insurance contributors, 2000 to 2002**

Segment and year	**Total employment** (millions)	**Percentage of employees contributing to:**				
		Pension	**Health**	**UI**	**Work injury**	**Maternity**
Employment in urban enterprises:						
2000	128.520	71%		65%		
2002	151.380	60%		53%		
Total urban employment:						
2000	212.740	49%	9%	49%	20%	14%
2002	247.800	45%	28%	41%	18%	14%

Source: China Labour Statistical Yearbook.

Published data suggest that compliance deteriorated between 2000 and 2002, except in the health insurance programme and in maternity insurance, where the coverage rate remained the lowest of any of the programmes. Among urban enterprises, contributors to the pension programme fell from 71 per cent to 60 per cent and contributors to the unemployment insurance programme fell from 65 per cent of the total to 53 per cent. The only significant gains were in the new health insurance programme, whose coverage increased from 9 per cent to 28 per cent of total employment in these two years.

To some extent, lower ratios of contributors to employees in the work injury, health and maternity programmes may simply reflect the state of transition from a system of employers' liability to social insurance. In each case, some employers continue to provide direct benefits rather than contribute to the social insurance pool. The adequacy of coverage for those not participating in the social pools is not known, but significant gaps probably remain. In pensions and unemployment insurance, however, low contribution ratios necessarily mean lack of benefit coverage. In each case, coverage trends point to serious future problems in financing current benefits and in assuring adequate income protection for future retired and unemployed workers.

Anecdotal evidence suggests particularly serious coverage problems among rural migrants, who in principle should be contributing and who probably account for a portion of those not contributing according to these data. Coverage gaps among the self-employed, at least with respect to health insurance and pensions, would be reflected in the relatively low incidence of coverage in the category of “urban non-enterprise.” Gaps among employees of township and village enterprises are not captured in these data as they are not classified as urban employees.

3.5.1.2. Improving compliance

Experience in other countries suggests that “magic bullets” for improving compliance with social insurance contribution requirements do not exist. In particular, alterations in the structure and financing of benefits do not appear to lead to improvements in compliance, in and of themselves. Instead, improving compliance requires careful attention to the design and implementation of effective administrative procedures to identify enterprises, assess actual contribution liabilities, and collect those liabilities. Improved procedures require, in turn, an adequate legislative basis, a political commitment to effective enforcement, and adequate administrative resources.

A first step toward improving compliance might be the enactment of an “umbrella” national social insurance law, together with complementary provincial social insurance laws, that clarify which workers are supposed to be covered and which are not, with specified conditions, if any, under which exceptions might be granted to the general rules. Currently, the legal basis of the entire social insurance system is a series of relatively brief directives issued by either the State Council or the competent Ministries. These establish a general structure but lack precise definitions and guidance about resolving conflicts between different laws and directives. A firmer legal basis for levying contributions should help clear up the current confusion about who is covered, when refunds are allowed, and which provisions take precedence when local authorities may have promised tax concessions to encourage private investment in their jurisdictions.

A second step might involve more careful coordination of enterprise registration requirements, including the use of common registration numbers by the tax, social insurance, and statistical authorities. Currently, each of these government agencies operates more or less independently of the others. Common registration numbers would facilitate comparisons of the list of enterprises registered with the respective agencies and of the financial information reported to each. It would also make possible the creation of systems to prevent enterprises whose social insurance contributions are in arrears from renewing business licenses or obtaining new bank loans.

A third step might be the streamlining of registration and payment procedures. At present, compliance can require enterprise officials to make personal visits to local social insurance offices where they must deal separately with representatives of each social insurance branch. It should be possible to comply with the payment and reporting requirements through one periodic financial transfer and one periodic report that could be filed electronically without having to obtain prior approval of a variety of clerks.

A fourth step might be reforms designed to assure greater political support for enforcement of current compliance requirements. Assigning responsibility for collecting contributions to an agency of the local government, whether it is the tax agency or the social insurance agency, invites conflicts of interest with respect to local enterprises that may be experiencing financial difficulties. Local government may reasonably decide that the immediate objective of preserving jobs is more important than the longer run objective of preserving pension rights. Provincial and national authorities might experiment with alternative institutional arrangements for collecting contributions, including use of the national tax agency or of agencies linked directly to the provincial government to see if such alternatives seem to allow greater political support for the collection effort.

Regardless of who collects contributions, increased emphasis is needed on data links and internal financial controls. Reports of contribution payments need to be cross- checked against reports to the social insurance agency of individual earnings amounts and individual account deposits, to the statistical agencies of total employment and average earnings, and to other local government agencies about the scope and financial results of enterprise operations.

3.5.2. Information and financial management

Weaknesses in information and financial management systems represent a barrier to the improvement of many aspects of the current social insurance programmes. Some of the steps just noted to improve compliance require the creation of modern information management systems capable of exchanging information with different sources, comparing reports and analysing differences.

Many of the attempts to improve programme administration and the control over financial resources are hindered by lack of modern information systems. For example, while the Liaoning pilot requires that all employee contributions be deposited in the provincial level account to prevent their being used to cover current benefit payments, there is, in fact, no way for the provincial authorities to know whether this requirement is being complied with fully. Provincial authorities lack an independent source of information as to the aggregate collections in each locality and have not centralized responsibility for maintaining individual account records. Similar weaknesses limit the effectiveness of the two-way account system that requires the finance department of the local government to hold any balances in excess of those needed for immediate transactions, but gives the finance department no independent information about how much should have been deposited in or withdrawn from the accounts it is maintaining.

The Chinese authorities certainly recognize these information and financial management limitations, but have until now had some difficulty in developing solutions to them which can be implemented in a satisfactory way across the entire country. An Information Centre at the Ministry in Beijing develops systems solutions and software to implement them, but has no way of requiring their adoption by the local authorities. The Liaoning pilot included initial steps to develop a national pension database, but the province itself has had difficulty implementing that part of the project.

Provincial and local authorities report several kinds of barriers to achieving significant improvements in information and management systems. Perhaps the single most important of these is the decentralized control over social insurance administrative personnel and resources. Local governments set the administrative priorities of local social insurance agencies, and not provincial or national authorities trying to improve information systems. Local general government authorities decide on hardware acquisitions, systems architecture, and software designs. Similarly, they decide on the size and composition of the social insurance agency staffs and the operating procedures that they will follow.

Improvements in information and financial management will probably require some change in the organization and/or financing of local social insurance administrative functions. One option is to move to a unified, vertical structure under which local social insurance agencies become branches of the provincial social insurance agency rather than of the local government. This is the common institutional arrangement for social insurance functions around the world. In most aspects of social insurance, having a standard treatment for all individuals and enterprises is usually considered to be more important than tailoring individual treatment to local circumstances. Standardized treatment is more easily accomplished in an institution structured vertically.

If it is not possible to reorganize radically the social insurance function, it may be possible to change the way in which it is financed. Shifting the responsibility for financing the administrative costs of local offices from the local government to the provincial social security ministry would give the provincial agency the ability to begin requiring standardized practices, system improvements, and adequate staffing and training levels. If even that is not possible, provincial level governments could at least assume responsibility for financing system improvements among local offices to assure that these improvements are undertaken and that the new systems built in each locale are compatible with those being built elsewhere.

A final barrier to the development of integrated information systems is the lack of a reliable individual identification number. The social insurance programmes are currently seeking to use the national identification number that is assigned and maintained by the state security authorities. In the past, however, they have found that this registration system is insufficiently reliable, with an incidence of errors — cases where more than one person has been assigned the same number — that is significant. The social insurance agencies also lack automated access to the master record that would let them identify the person that was originally assigned a given number. Access to such information is an essential element to assuring the accuracy of the information fed into local databases and accurate local information is an essential element in ensuring that a national database can be constructed based on the information entered into the individual databases. The social insurance authorities must either work to correct the problems with the current numbering system or create a system of their own before substantial improvements in information management are possible.

3.5.3. Improved financial planning

Currently there are no official projections of the future financial status of the various branches of social insurance, which is particularly troublesome for the pension and unemployment insurance programmes. There is insufficient capacity for analysing the impact of current policies on the cost and adequacy of benefit protection, which is detrimental for planning in the health insurance programme. Neither is there sufficient data to calibrate work injury contribution rates to expected industry incidence rates. In each case, additional administrative resources are needed at least at the provincial and national levels to better understand the operations of these major social programmes.

Concluding observations

Amongst all of the subjects to which the government must attend in any country's social sector, social security stands out as being, by its very nature, that demanding both the longest term perspective, and also subtlety of policy making responses as economic and demographic conditions, and perhaps also the political environment, inevitably change.

The need for such responsiveness is magnified greatly in the conditions of such a large, diverse country as China, with a rapidly evolving economy, and it is hardly surprising that the complex way in which the social security system has developed reflects those changes in full measure. The foregoing chapters have presented a survey of the history over the last 50 years of the development of the social security in China, tracking at least the major changes. However, even as such a survey is committed to paper, we are well aware that the next round phase of evolution cannot be far away. The objective of policy, nevertheless, must be to provide a stable framework within which the administration of the various social security schemes can operate effectively — ultimately, of course, to meet the real and human needs of the present and prospective scheme members.

The commentary in the preceding chapters has been structured around a description and analysis of each, in turn, of the different schemes of social insurance (providing respectively, pension, health care, work injury, unemployment benefits and maternity), as they have developed historically and been implemented in rather different conditions prevailing in the thirty or so provinces and municipalities of the country, together with the main schemes of social assistance. Within that commentary will be found, naturally, pointers to the main issues seen at present and likely in the forthcoming years to exercise the attention of policy-makers, together with some guidance as to the advantages and disadvantages of different options, reflecting the international experience and perceptions of the team of authors, and within the framework of principles which guide all of the ILO's work in social security.

The aim of this short Chapter, then, is to draw together some of the key themes emerging from the analysis of the schemes, in the context of the ongoing effort to create a coherent and integrated — as far as possible — system of social security protection for China's workers and their families. Perhaps the most pressing of all issues centre on the need progressively to increase the equitable distribution of the fruits of economic growth between the urban and rural areas of the country, and the role of the different component schemes of the social security system in achieving that. Certainly, the scope and coverage of the schemes stands to be extended, and the ILO completed a study in December 2005, sharply focused on this specific subject. The perspectives of that study are reflected throughout the commentary in this paper, but more closely in the conclusions presented here.

Throughout, we keep in mind the underlying theme of social harmony, and the role of social security in its promotion. To begin, we may point to the need for a strong formal framework within which to develop the policies and institutions needed to implement any form of social security. While a very great deal of effort has been devoted over recent decades towards the development of appropriate policies, not only at the national level but also at the level of the provincial and other subsidiary administrations, that effort has not yet been expressed in the form of workable laws. The drafting of legislation, for both the national and provincial levels, should be treated as the most urgent of tasks in this field.

The formulation of satisfactory legal provision will provide the basis for strong, representative institutions through which the system of social security can be administered on a long-term basis. Without such a legal foundation, much responsibility rests in a rather indeterminate way with the government administrations, and yet there is hardly a basis on which to develop the range of management, administrative and technical skills which should underpin an efficient and effective system, which can properly serve the country. Our second, major observation, therefore, is the need to commission a study — or range of studies — to determine the optimum way to ensure the long-term capacity of the social security institutions. The specific capacities of concern in this regard include their abilities to undertake their functions of administration, planning, finance and fund management, together with their ability to recruit and train staff with the appropriate skills.

Our third group of observations concerns the complex way in which the system of pooling of liabilities for the purposes of the social insurance components of the social security system has developed, and has become fragmented across the provinces of the country. While this degree of decentralization has the considerable advantage of allowing the schemes to respond in an effective way to local conditions, the theory of risk and insurance points to the crucial importance of grouping members into risk pools which, within the need for sufficient homogeneity, are as large as possible. This provides a fundamental reason, in most countries, to manage social insurance schemes at the national level, so that as far as possible any cross-subsidies which are needed take place within the system itself, rather than from the government treasury. This set of issues, which is evidently wide in scope and technically complex, itself now merits special studies.

Fourthly, the studies undertaken by the ILO, and others, highlight the need to resolve the problems found in providing adequate social protection for the rapidly growing numbers of workers who move from rural to urban areas in response to the shrinking needs for farmers "on the land", offset by the new labour demands in the urban areas created by, to choose only one amongst many examples, the construction industry. There are certainly difficult issues to resolve, in the context of a system which has been conceived in such a way as to meet separately the rather divergent needs of rural and urban residents, but a start should be made by establishing in a suitable enabling law the right of migrant workers of access to social security provision.

Next, we observe the need to study in closer detail than hitherto a number of features of the social security system of a "parametric" nature. Several of these reflect the increasing (and gratifying) longevity of the populace of China, which has accelerated much more rapidly than could easily have been predicted a few years ago. This development impacts on social security provision in a number of different ways. One is the need to pay pensions for much longer periods than hitherto; this in turn is beginning to reveal financial stresses in both the socially-funded elements and the individual-account elements of the social security pension schemes, with conversion formulae relying on divisors which increasingly fail to reflect actual years of life expectation amongst pensioners. Another is the increasing need for medical care appropriate to a range of conditions and illnesses prevailing amongst the elderly. The important question as to whether pension payments to men and women should in future begin at equal ages provides an opportunity to remark that there is in fact a much wider range of issues affecting the equity of treatment as between male and female scheme members.

Our sixth group of remarks concern the investment of the large sums payable to schemes by way of contributions, together with assets accumulated over past years. This topic entails a particular degree of complexity because of its important and wide-ranging links to national policy concerning economic and financial matters generally. Nevertheless, the question as to how investments should be managed, including the extent to which they may or should be diversified, has a direct impact on the effectiveness of social security provision, particularly in the pensions branch, and within that branch, in relation to the individual-account component.

Behind each set of our observations is the recognition that, while the system of social security has been built up in such a way as to provide, in principle, opportunities to cover more or less every category of workers and their families, in practice full coverage has by no means been achieved as yet. Accordingly, efforts should be redoubled to being into coverage all of those who already meet the eligibility conditions. Coverage of urban workers could and should be completed without delay. This may be accelerated — and disincentives to employment alleviated — by easing conditions (for example, through subsidizing contribution rates) for employees of smaller enterprises, and this should be given close consideration. It is recognized that the expansion of coverage for rural workers may take longer, but facilities can and should be opened fully for employees of the “non-public enterprises”, traditionally known as “township and village enterprises” (TVEs).

In summary, China stands at a crossroads in relation to its social security system. The system has developed in a way which uniquely reflects the circumstances in the country, and faces many and considerable challenges. Much valuable knowledge has been gained through the range of provisions that have been tested in the recent pilot schemes introduced in selected provinces. However, the opportunity now to strengthen the system as a whole, together with its institutions, is very clear, and, for social security observers worldwide, the scope for bringing effective social protection to perhaps one fifth of the world’s workers, is truly exciting.

Annex I. Summary legal provisions: Old-age pension insurance

AI.1 Law/Regulations

There is no pension law in force, but the pension system is regulated by a series of decisions of the State Council and of the MOLSS, the principal one being the *Establishment of a Unified Pension Insurance System for Enterprises Employees* (*Decision No. 26* of the State Council).

AI.2 Coverage

Coverage generally limited to enterprise workers and individual workers in urban areas.

AI.3 Contributions

Definition of covered salary

- For the employer: Total payroll of its employees. However in Guangdong, the salary base is the same as the one used for workers (see below).

- For workers: Total cash salary, including overtime, bonus and cash allowances, minimum 60 per cent of the average wage, maximum 300 per cent of the average wage.

Contribution rates

The *Establishment of a Unified Pension Insurance System for Enterprises Employee*s (*Decision No. 26* of the State Council) specified the following contribution rates in 1997:

	Pooling	Individual accounts	Total
Employer	13%	7%	20%
Worker	—	4%	4%
Total	13%	11%	24%

The contribution rates have been modified by the *Trial Arrangement of Completing the Urban Social Security System* (*State Council Document No. 42*) for the Liaoning pilot project, as follows:

	Pooling	Individual accounts	Total
Employer	20%	—	20%
Worker	—	8%	8%
Total	20%	8%	28%

In Guangdong province (varies by pooling unit)

	Pooling	Individual accounts	Total
Employer	11%–12%	5%–6%	16%–18%
Worker	—	5%–8%	5%–8%
Total	11%–12%	11% (fixed)	22%–23%

Generally, the employers' contribution rate is not supposed to exceed 20 per cent of the total payroll. However, autonomous provincial regions and municipal governments may decide specific rates. If the rate is higher than 20 per cent, it is necessary to report to the Ministry of Labour and Social Security (MOLSS) and the Ministry of Finance (MOF) for approval.

AI.4 Benefit eligibility conditions

Contributions are to be paid for at least 15 years (before 1998, it was ten years).

The normal retirement age is 60 years for men and 50 years for women (55 years for managers). However, in certain physically demanding industries and for employees of bankrupt SOEs, the retirement age may be five years earlier.

AI.5 Pension formula

In Guangdong province

For 1994–June 1998

Pension at the time of award	Indexation (July every year)
Basic pension 30% of previous year's Social Average Wage (SAW) of the city	In line with the increase in SAW
Additional pension Career average of indexed contributory wage — *x* number of years of contribution — *x* coefficient (generally less than 1%	Adjusted by 40% to 60% of the increase of the average contributory wage of the city
From individual account Balance in the account divided by 120	Adjusted by 40% to 60% of the increase of the average contributory wage of the city

From June 1998

Pension at the time of award	Indexation (July every year)
Basic pension 20% of previous year's SAW of the city (25% for managers)	In line with the increase in SAW
Transitional pension (for workers who joined before July 1998) Career average of indexed contributory wage *x* number of years of contribution before July 1998 *x* coefficient (1% if contributed for more than 10 years, 1.2% if contributed for more than 15 years; for each year of hazardous work before July 1998, 0.2% is added to the coefficient) + 10% of SAW in 1997 (fixed, devalues over time)	Adjusted by 40% to 60% of the increase of the average contributory wage of the city
From individual account Balance in the account divided by 120	Adjusted by 40% to 60% of the increase of the average contributory wage of the city

Other benefits

- For workers who joined the scheme before July 1998 but contributed for less than 10 years: Lump-sum: Career average of indexed wages x 2 *x* Number of years of contribution before July 1998
- For workers who do not qualify for a pension: Refund of the balance in the individual account
- Funeral grant: 3 times SAW of the previous year
- Survivors' grant: 3 times SAW of the previous year (for pensioners) and 6 times SAW of the previous year (for active workers)
- Assistance for dependants: 6 times SAW of the previous year

AI.6 Pension financing

Financial pooling is organised at a provincial level to adjust surplus and deficits at local and regional levels. In principle, the Treasury does not subsidise the pension scheme. However, as some provinces have had severe deficits in recent years, the Treasury has been asked to subsidise them.

Liaoning and Guangdong have adopted a “sub-pooling mechanism” (Solidarity Funds). In Guangdong, for example, all pooling units contribute 3 per cent of the collected contributions to the county sub-pooling fund (PF) and 3 per cent to the city sub-PF to cover deficits in poor localities. Guangdong had started this mechanism before the Central Government planned to establish pooling mechanisms at provincial levels. Up to now, Guangdong has received no subsidy from the Treasury.

In most provinces the individual accounts are notional; that is, there is not enough accumulated reserve to cover the full benefit liability under the defined contribution tier. Contributions to the individual accounts are deposited in Banks or invested in Treasury bonds. The interest earned on the individual accounts is reported every year.

AI.7 Benefit portability

In the case of the basic pension, the workers’ contribution records are transferred when they move. For a retired worker who contributed to multiple funds, the pension is calculated on the basis of the worker’s total contribution period. The pensions, however, are paid by the last scheme to which the worker had contributed.

The individual accounts are transferable. When a worker moves from one fund to another, the accumulated capital is transferred accordingly. Rural migrant workers can liquidate their individual accounts when moving to another location. Given that the individual account is notional in many funds, large-scale migration may cause financial problems.

Annex II. Summary legal provisions: Unemployment insurance

AII.1 Law/regulations

No specific law applies but in 1999 the State Council issued the *Regulations on Unemployment Insurance*. The Labour Law stipulates several obligations, such as the obligation for enterprises to provide unemployment insurance (UI) for their workers.

AII.2 Coverage

All enterprise workers, including those in private enterprises (domestic and foreign capital) are covered. Provincial authorities, autonomous regions, and municipalities directly under the Central Government can extend coverage to other units.

In Guangdong, rural migrant workers, self-employed and enterprise workers in rural areas, in township and village enterprises (TVEs), are covered. As of 2001, civil servants are not covered but coverage may be extended to include them in Guangdong from 2002.

AII.3 Contributions

The base contribution rates are 2 per cent from employers and 1 per cent from workers. However, contributions may vary at the provincial level. Employers contribute on average 1.5 to 2 per cent of total gross wages and workers on average contribute 0.5 to 1 per cent of their gross wages. Rural migrant workers who contracted with urban enterprises do not pay contributions. In the case of Beijing, the contribution rate is 1.5 per cent for employers and 0.5 per cent for workers. In Guangdong, employers pay on average 2 per cent and the workers 1 per cent. In Shenzhen the employers' contribution rate is as low as 0.4 per cent.

The covered wage is defined the same way as for pensions.

AII.4 UI financing

Contributions are paid to local funds. There are more than 1,000 funds. Deficits and surpluses are balanced at the provincial level. The Treasury pays two kinds of subsidies to cover the deficits at the provincial level. The first is a subsidy to the funds from the general reserve, which is used for financing benefits and administrative costs; the second is a direct subsidy to enterprises, which is earmarked for benefit expenditure.

The financing system operates on a pay-as-you-go (PAYG) basis but there is an accumulated reserve of 20 billion yuan at the national level. The surplus, i.e. the part of income in excess of the benefit payment, is deposited in banks and earns interest.

AII.5 Benefit eligibility conditions

To qualify for the unemployed cash benefit, a worker has to have contributed for at least one year. Unemployment has to be involuntary and the applicant should register as unemployed and be willing to and available for work.

AII.6 Benefits: Cash compensation and other support services

Benefit levels are set by authorities at the provincial level, or at the level of autonomous regions and municipalities directly under the Central Government, where applicable. The benefit is a fixed rate and is not related to the previously earned wage of the individual worker. The average replacement rate is about 30 per cent. In general, the replacement rate should lie between the local subsistence level (i.e. the local level of social assistance) and the local minimum wage. In Beijing, for example, the minimum wage is 390 yuan per month, the unemployment cash benefit is 373 yuan, and the subsistence level is 270 yuan (for an adult). Nationally, the benefit levels are adjusted on an ad hoc basis to keep pace with inflation and wage increases. In Guangdong the benefit increases are linked to increases of the statutory minimum wage, which is normally adjusted in line with inflation (CPI).

In Guangdong, urban unemployed workers receive benefits on a monthly basis. The benefit level is set at 80 per cent of the statutory minimum wage. (In Guangzhou, the subsistence level is 400 yuan.) However, unemployed workers receive approximately an additional 10 per cent allowance to cover medical expenses (the allowance is a flat-rate). In addition, the scheme reimburses 50 per cent of hospital costs. Rural unemployed workers receive a lump sum equal to the sum of 1 per cent of the total gross wage for each year of past employment. This is equivalent to the refund of half the contributions. The remaining half is used by the scheme for other benefits.

The unemployment benefit terminates when an unemployed worker accepts a job offer. National guidelines specify three categories of maximum benefit duration according to the number of years of contributions: 24 months for workers who have an employment record of ten years and more, 18 months for those with five to ten years of employment and 12 months for those who have a prior employment record of less than five years (but more than one year).

After the expiration of the unemployment benefit, social assistance is paid in case of need. If a breadwinner is unemployed, a claim for additional social assistance benefits may also be made when the unemployment benefit is below the family's subsistence level. The unemployment benefit expires when the unemployed person reaches retirement age and eligible for an old-age pension.

When a beneficiary dies, his/her dependent relatives qualify for survivors' benefit. The level of the survivors' benefit is equivalent to that received by the survivors of workers in SOEs. In the Guangdong, the maximum duration for the survivors' benefit is six months.

The scheme provides allowances for vocational training and the use of employment services by certified private providers (public employment services are free of charge.) The allowance is transferred directly to the re-employment centre. The allowance varies according to the difficulty of individual placements. The assessment of the degree of difficulty different occupational groups is left to the discretion of the local social insurance agencies.

Further to the above benefits, the unemployment insurance scheme pays medical subsidies during the unemployment period and funeral grant and survivors' benefit (to dependent spouses and relatives if an unemployed person in receipt of the unemployment benefit) dies, as well as other expenses such as primarily resources to secure a basic livelihood.

Annex III. Summary legal provisions: Employment injury insurance

AIII.1 Law/regulations

Current provisions of Employment Injury Insurance (EII) are described in *The Interim Regulations on Occupational Injury & Disease Insurance for the Employees in Enterprises (IROIDI).* They were enacted in 1996 by the MOLSS and came into force in the same year. China is paying close attention to the drafting of complete Regulations on Occupational Injury & Disease Insurance (ROIDIAE); it is expected that the State Council will both enact and implement them in 2002. Current and contemplated regulations do not apply to government employees that are covered under a different system.

Regarding occupational safety and health (OSH) at work, a legislation system has been established over the last 20 years. It is composed of laws, regulations and rules as well as the standards concerning safe and health production at working place.

AIII.2 Coverage

In principle, coverage is compulsory for all urban enterprises. The province has the power to extend the coverage to rural areas. Employers not participating in the pool system may pay directly the benefits to the workers. Workers of employers not participating to the pool may sue their employer before the courts.

AIII.3 Contributions

The EII scheme is funded entirely from contributions of employers. The contributions vary by industry. The structure of classification by industry may vary at the pool level. In Guangdong province, the classification structure is the same for all pools. In Liaoning province, each city has its own set of rates. Existing classification structures show significant variations. For example, there are three rates in Guangdong province (0.5 per cent, 1.0 per cent and 1.5 per cent) while there are 6 rates in Fushun City ranging from 0.3 per cent to 2.8 per cent. Industry rates can be adjusted to consider the experience of individual employers. This mechanism has started to be used in Liaoning province, but Guangdong is reluctant to use it because it has doubts about its impact on the behaviour of employers towards safety and health at work. The national level believes that experience rating is an important tool for prevention. The average contribution rate depends on the industry mix of each pool. Contributions rates do not reflect fully the cost of employment injuries because a significant part of benefits (temporary compensation and permanent partial disability) is paid directly by the employer to the worker. In 1999, the average contribution rate was 0.77 per cent of the payroll.

Contribution rates are applied to the salaries of the previous year in order to ease the administration.

AIII.4 Financing

Contributions are paid to the pool and they are used to pay the benefits. The Government pays administration costs from general revenues. Financing is made on the PAYG basis. The excess of contributions over payments is defined as a surplus. However, long-term pensions are paid to permanently disabled persons or survivors of deceased workers and the corresponding liabilities are not considered in the current appraisal of the financial situation. Accumulation of appropriate assets to cover the future payments of those pensions is not a concern. Consequently the PAYG basis seems to be the framework. On the other hand, the apparent intention of the experience rating formulas and the provisions dealing with bankruptcies of state-owned enterprises (SOEs) seem to imply the fully-funded approach.

The province level may set up financial arrangements in order to subsidise pools that are in a deficit position. For example, in Guangdong province, 9 per cent of contributions are transferred to the city level and 6 per cent to the provincial level.

At the national level, the total amount of reserve accumulated was 4.2 billion yuans at the end of 1999. The benefit payments in that year were 1.2 billion yuans. No data is available to appraise whether the amount of assets covers the liabilities related to pensions in payment.

AIII.5 Benefit eligibility

In EII, any worker is entitled to benefits as long as he suffers a work related accident or occupational disease. The administrative unit of social insurance has the responsibility to make the decision regarding the eligibility. The definition of work accident includes transportation to and from work, but the amount of benefits in those circumstances may be related to the degree of fault of the worker.

AIII.6 Benefits

The insurance system provides for benefits in kind and in cash. Benefits-in-kind include medical care and rehabilitation services. Benefit in cash includes invalidity pension for temporary and permanent disability and survivors' pension.

Medical care benefits include the cost of hospital service and medical treatment, drugs, travelling expenses to the hospital from another city. The worker is encouraged to accept medical treatment in company's clinic, contracted hospital and local hospital. Whenever it is impossible, approval by the authority is required.

Rehabilitation benefits refer to vocational training and assistance equipment such as artificial limbs, home or vehicle adaptation to the worker's disabling condition. Rehabilitation benefits are generally very limited due to lack of resources. They vary according to the facilities available in the area. In 2001, Guangzhou City started to operate a vocational rehabilitation centre, which has modern and comprehensive equipment and specialized staff. There is a desire to make this kind of facility available all across the country.

Compensation for temporary disability refers to the period when the employee in unable to work because of his physical condition and needs to receive medical treatment. The employer has to pay the salary to the worker for a period of 24 months, 36 months in the case of severe injuries. The average salary of the 12 months preceding the injury is used. The new regulations will reduce those periods respectively to 12 and 24 months. This change would aim at speeding up the medical treatment. Compensation for temporary disability is fully paid by the employer who receives no reimbursement form the insurance system.

If the worker suffers a permanent disability, a committee assesses his impairment. A lump sum ranging from six to 24 months of wages will be awarded according to the disability scale according to the following table.

Table AIII.1 Lump sum for permanent disability

Grade of disability	Months of wages
1	24
2	22
3	20
4	18
5	16
6	14
7	12
8	10
9	8
10	6

A pension is paid to injured workers with grades of disability under 7. Those with grades 1 to 4 are considered totally disabled and are awarded a lifetime pension paid by the insurance fund. The amount of the pension is based either on the individual salary of the worker or the average salary of the workers of a reference group, which could be the workers in the province or the city. The rate of replacement varies with the grade of disability. It ranges from 90 per cent for grade 1 to 75 per cent for grade 4 decreasing by 5 per cent for each grade.

Injured workers with grades 5 and 6 are considered to suffer a partial loss of earnings due to their impairment, which ranges from 33 per cent to 67 per cent. Their employer can offer them a suitable job with the same salary that they had at the time of the accident. The employee may accept or refuse the work. If he refuses the job or is not offered a job by the employer, the disabled worker is entitled to a temporary pension payable until he reaches the normal retirement age. The rate of replacement is 70 per cent. The employer, who gets no reimbursement form the EII fund, pays the pension. This financial arrangement is a strong incentive to reinserting the injured worker into the workplace.

Permanently disabled workers with grades 7 to 10 are not entitled to any pension. In Guangzhou, they are eligible to vocational training at the rehabilitation centre.

Benefits paid to survivors of workers, deceased from an occupational accident or disease, are shown in the following table. Pensions to the spouse are paid for life and cease at remarriage. Pensions to orphans are paid until age 18. The province has the authority to stipulate replacement rates different to these specified benefits.

Table AIII.2 Benefits in case of death from work related injury or disease

Funeral benefit	6 local month average wage
Lump sum	48-60 local month average wage in last year
Survivor's pension	Local month average wage in last year, 40% for spouse, 30% for others, plus 10% for old-age, survivors and orphans

Indexing of disability and survivors' pensions is provided through a general statement in the regulations at the state level. The power of setting the formula is left at lower levels.

AIII.7 Relationship between EII system and OSH activities

The responsibility of safety at work is under the authority of the State Economic and Trade and Commission. Its mandates include the design of regulations and the inspection of workplaces to ensure compliance. The responsibility of occupational health falls under the authority of the Ministry of Public Health. Whenever an injury accident occurs the local bureau should be informed. Depending on the severity of the injury, an investigation will be conducted. There is no formal exchange of statistical data between the EII system and the parties involved in OSH activities. The current institutional framework probably makes difficult the appropriate targeting of industries and employers with bad records in OSH. Circulation of appropriate statistical data may help all parties to increase efficiency in the management of OSH.

Annex IV. Summary legal provisions: Health insurance

The public HI systems were established as early as 1950s, the initial stage of the establishment of the P.R. China. For the urban population, there were two main HI systems in operation: the Labour Health Insurance System for workers and dependants (LHIS) and the Government Health Insurance System for civil servants and public workers (GHIS). For the rural population, the Cooperative Health Insurance System (CHIS) was developed with government subsidies. In addition to the above, limited social assistance programmes as well as specific health programmes targeting on specific privileged groups, such as revolutionary veterans, were available too.

In the early 1980s, the overall coverage under the old public HI systems was remarkably extended, nearly 80 per cent of the population had, to some extent, financing access to health care. However, the coverage dropped dramatically following the economic system restructuring, notably the SOE reform in urban China and the cooperative system reform in rural China, as the old HI systems were basically employer-liabilities. Thus, there is an apparent need for reforming and re-establishing health insurance systems.

The Government has decided to start the reforming from the urban HI systems. A uniform BHIS for all urban working population is going to be established throughout the county. The establishment of the BHIS will last several years, therefore a transition period is foreseen, during which parallel public HI systems, i.e., the new BHIS and the old systems, will coexist, notably in the urban areas. Upon the completion of the establishment of the BHIS, efforts should be given to how to effectively and efficiently provide HI coverage for other people who are not insurable under the BHIS for the moment.

The BHIS consists of two components: a pooling fund based on social insurance principles and individual medical savings accounts (IMSA) without solidarity ingredients, which forms one of the core contents of the HI reform.

AIV.1 Coverage

All employees and retirees of urban establishments, including enterprises irrespective of their nature of ownership, government’s departments and offices of the CCP, non-economic undertakings, etc., are obliged to participated in the BHIS. The compulsory coverage for other urban groups, such as workers of TVEs, the self-employed persons and their employees, is subject to the discretion of local governments.

Senior/cadre retirees, revolutionary veterans and soldiers with an invalidity degree equivalent to Degree II of Category II or higher are exempt. The Government is still directly responsible for these privileged groups.

Military personnel are exempt too from the participation in the BHIS. However, a special health scheme has been separately set up for them. In line with the principles laid down in related regulations, each person undertaking military services has an IMSA under the scheme, regular contributions from the individuals and military authorities are distributed accordingly to each IMSA. No accumulated balances in these accounts can be actually withdrawn until the person in question withdraws from the army. At that time, the overall balance in an IMSA under the special military scheme will be transferred to a person’s IMSA established under a scheme of the BHIS where the person works or lives.

Coverage for dependants, especially for children, is not mentioned in all legal documents, so actually excluded too. The intention is to leave them for the moment to the old systems. Given that, children would face one of the following scenarios: *(a)*, some of them are still insured, fully or partially, under the old systems; *(b)* some have no HI because either the old systems stop functioning or did not have one; and *(c)* some participate in a collectively-arrangement insurance programme which usually provides an overall insurance package for life and health for students of premier and second schools. The latter one may overlap with the first. No detailed statistics are available at the time of investigation.

AIV.2 Contributions and financing

The schemes are financed by employers' and workers' contributions. Insured retirees are exempt from paying contributions. Contribution rates vary from one scheme to another, but around 8 per cent of the payroll in total, out of them, 2 per cent from workers. Administration costs are fully covered by government budgets. The financing of the BHIS is based on PAYG system.

Contributions collected are distributed between two components. The general rule for distribution is that all workers' contributions are allocated to the IMSAs of respective individuals, the latter are further added by around 30 per cent of the total employer contributions. It should be noted that the distribution is not even among the insured persons, it is normally in line with the ages of workers/retirees. The rest of employers' contributions, i.e. 70 per cent, are then devoted to the HI pooling fund.

Lower contributions can be applied to the following groups: *(a)* laid-off SOE workers. The amount of employer and individual contributions due can be calculated at 60 per cent of the average regional wage of the previous year. They should be entirely paid by respective Re-employment Centres, and *(b)* Workers of SOEs with financing difficulties. Only employers' contributions are required to be paid; the workers can be exempted. Furthermore, the employers' contributions would be calculated at a reduced rate whole diverted to the HI pooling fund. This implies that during this special period, no financing resource will be accordingly allocated to the IMSAs, respectively.

AIV.3 Benefit eligibility conditions

The insured person has already registered with a designated HI agency, with personal contributions and those of the employer having been paid. No waiting period is required.

AIV.4 Benefit package

Benefits available under the BHIS include general practitioner care (community health services), domiciliary visiting, specialist care at hospitals for inpatients and outpatients, and essential pharmaceutical supplies prescribed by doctors. Subject to the reimbursement ceiling for the overall annual medical costs and the stipulated scope of the insurable medical items, the benefits are granted throughout the whole period of contingency.

These benefits are separately available under the two components: IMSAs and PF. In principle, medical costs for non-grave diseases, where normally only outpatient care is required, should be covered by the balance accumulated in a specific IMSA, while that for severe diseases, where usually specialised inpatient care is required, should be met under the PF.

Thus, the savings balance accumulated in an IMSA, if available, shall cover the first 10 per cent of the total annual medical cost occurred by the insured person in question. Only above threshold of this 10 per cent, will the PF assume responsibility and pick up the bills. However, a benefit ceiling is set at four times the average regional annual salary, and thus excessive medical costs will not be reimbursable under the BHIS.

It should be noted that only costs spent on those drugs, medical services and laboratory tests and clearly specified as insurable medical items via the Official Lists are counted and reimbursable under the PF component. The List of Drug groups the insurable medicines into two categories: Category I and Category II. The content of the Category I is exclusively determined by the national authorities, while 15 per cent of the latter be determined by provincial governments. Reimbursement rates are different in that those for Category I are normally higher than those for Category II. In respect of reimbursable medical services and laboratory tests, the National List prescribes which items should not at all be insured and which items should be partially insured. Provincial governments are authorized to extend the scope of non-insurable medical items and adjust, to some extent, the content of the partially insurable list.

For all costs reimbursable under the basic HI system, co-payments by the insured patients are required. The rates of reimbursement vary considerably between different schemes, and within a scheme they depend on a number of factors such as the age of the patient, the classified level of medical services used, etc.

AIV.5 Administration and monitoring

In principle, the HI schemes should be pooled and managed at the prefecture level or above, but it is possible to do so at the county level.

They are locality-based schemes. Employees and retirees should participate in a local scheme where their working units are located or their homes are based. In other words, there should be no basic HI schemes organised on an industry / occupation basis.

Labour and Social Security authorities of the Government have overall responsibility for the administration and monitoring of the basic HI schemes, while their HI agencies are designated for day-to-day management. Meanwhile, the other related government departments, particularly Departments of Finance, Public Health, Drug Monitoring should closely coordinate with the former. A supervision committee for the management of HI funds should be set up with representatives from the government departments, employers' and workers' organisations, health institutions and the others.

Each basic HI scheme should open two fiscal accounts, one for contribution revenues and one for benefit payments. These accounts are under the close supervision of the Finance Department.

The HI agencies are also responsible for the management of supplementary HI programmes for civil servants. Regarding the question of who shall run complementary HI schemes for workers, it is open to the local governments to determine. They can be operated either by the same HI agencies, or by commercial insurance companies, or by social organisations.

AIV.6 Health services provisions

The scopes and standards for the insurable health services, medicines and tests under the basic HI system should be determined and announced by local authorities in line with the national guidelines. Beyond the scopes, medical items are not insurable under the basic HI system.

Health suppliers, including medical institutions and pharmacies, are to be contracted on an equal competition basis. Based on that, each insured person can choose a number of health suppliers at different levels. In certain cities, each insured patient can even go to see any health suppliers who are on the contracting list.

Community health services are encouraged to develop and to be used by the insured patients.

AIV.7 Providers' payment mechanisms

They are not specified in the regulations. In practice, basically, it is fee-for-services, but an average cost per hospital stay per hospital is usually imposed. Studying and even developing a per-case payment mechanism in the future has been planned by a number of schemes' managements.

AIV.8 Health and drug sector reforms

It is considered that without simultaneous and corresponding reforms undertaken in the health and drug sectors, the basic HI system cannot be successfully established.

The State Council convened two national conferences on these three related reforms in the last two years. Mr. Li Lan Qing, Vice Premier, chaired the conferences. The main purposes of these events were to review, monitor, harmonize, guide and push forward the three reforms. All official documents of the latest conference have been seized.

The key contents of the health sector reform include the re-planning, re-allocation and restructuring of regional health resources to improve the utility rate and to ensure everyone an access to basic health services; the reforming of medical institutions to set up a reliable, self-disciplining, competitive and vigorous mechanisms for the operation and human resources development; to rationalise the current income-generating system, separating hospitals' two main income-generating activities: medical services and drug selling; distinguishing two types of medical institutions: profit-makings and non-profit-makings, and formulating corresponding policies for them, including that on tax, price, human resources, investment, etc.

AIV.9 Provisions for supplementary benefits

For medical costs beyond the established reimbursement ceiling under the basic HI schemes, supplementary programmes should take over if available. In terms of the source of financing and the nature of the schemes, three types of systems can be distinguished. One is for civil servants, compulsory, fully funded by the government revenues and run by the public HI agencies. The second is that for workers, voluntary in general, possibly financed by extra contributions not exceeding 4 per cent of pre-contribution payroll. The third is that for the insured persons who are extremely poor, supported by a solidarity fund consisting of contributions from the governments, employers in question and other donors.

Within the above-mentioned second category, the complementary schemes existing in the country are in three types:

- Complementary HI programmes for severe sicknesses designed and run by the public HI agencies. The personal coverage would be as broad as the basic HI scheme as the participation would be, in practice, rather compulsory. As to the financing, they are based on the PAYG system. Annual premiums per person would be around 50-70 yuans, which normally allow an easy extension of the annual insurable ceiling stipulated under the basic HI scheme from 35,000-40,000 yuans to 185,000-190,000 yuans at a reimbursement rate of 60-90 per cent. Premiums are often shared between the employer and the insured person, or fully borne by either of them.
- Solidarity schemes for severe sicknesses of workers designed and run by the trade unions. The participation is voluntary and the scope of coverage is limited to the working population affiliated to the trade unions. These schemes are mainly funded by workers' contributions with some subsidies from employers and trade unions, and based on PAYG principles. The benefits provided are aimed at both the extension of coverage of medical costs exceeding the insurable maximum available under the basic HI scheme and out-of-pocket payments occurred beneath the ceiling.

Commercial complementary HI schemes. It can be arranged between a public HI agency as a media and contribution collector and a selected commercial insurance firm, or directly purchased by individual employers or workers from a commercial company. Deductible contributions for this purpose can be up to 4 per cent of payroll.

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