The development and prospects of China’s old-age security system

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On the basis of a description of the framework of China’s urban and rural old-age security system and major security policies, this study examines the operation of the old-age security system currently in effect. From the point of view of setting up a system that would cover both urban and rural areas, we can see problems with the current system, including a development imbalance between urban and rural social security, wide gaps between different groups, the absence, fragmentation and artificial segmentation of the social security system, blurred government responsibility, etc. The paper goes on to propose establishing an old-age subsidy for urban and rural residents without income security, improving basic old-age insurance for enterprise employees in urban areas, reforming the superannuation schemes of government organizations and public institutions, and setting up rural old-age insurance.

Keywords: old-age security system, basic old-age insurance system for urban enterprise employees, superannuation scheme, rural old-age insurance, old-age subsidy

China set up its old-age security plan as early as the planned economy in the early 1950s. Since the 1980s, it has been promoting the reform and development of an old-age insurance system. After nearly 30 years of reform and practical experiment, a preliminary old-age security system with Chinese characteristics has been set up. Data from the Fifth National Census show that people aged 60 and over account for 10.4% of the entire population; China has become an aging country in terms of demographic structure, according to the standard established by the United

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Nations. However, China is still an underdeveloped economy, with an urban old-age security system that has made obvious progress but is far from perfect, and a rural system that has basically not yet got under way. There is still a long way to go to solve the problem of “making provision for the elderly” in a situation where we are getting old before we get rich.

I. China’s current old-age security system in urban and rural areas

1. The framework

Like the dual social and economic structure, China’s social security system, and especially its provision for old age, has been marked by urban-rural differentiation and segmentation.

The framework of the social security system for old people is made up of three main planks: the system for urban residents, that for rural residents, and that for migrants. The urban component has basically developed into an old-age security system covering most of the urban working age population, including basic old-age insurance for enterprise employees in urban areas and a superannuation scheme for staff of government organizations and public institutions. In the rural areas, however, no overall old-age security system has been set up and there is a blank at the national level. Although some areas have been experimenting with the establishment of a rural old-age insurance system since the 1990s, no final model has been adopted and thus it has been impossible to have a full-scale roll-out. In respect of the floating population, two old-age insurance schemes have been established respectively targeting rural migrant workers and farmers whose land has been expropriated, but overall, these schemes have a clearly local and partial character, and a uniform national system has not yet been established.

Because of the huge differences in regional economic development, the setting up of an old-age security system is characterized by clear regional differences. In economically developed regions like Beijing, Shanghai and some parts of Jiangsu Province, a noncontributory urban scheme and a rural old-age subsidy scheme have been set up, forming a system that combines both contributory and noncontributory modes.

2. Major policies

China’s urban and rural old-age security system mainly comprises basic old-age insurance for enterprise employees in urban areas, rural old-age insurance and superannuation for the staff of government organizations and public institutions.

Basic old-age insurance for enterprise employees in urban areas is the principal part of China’s urban and rural old-age security system. It is financed by both employers and employees, with the government being responsible for providing a subsidy and baseline assurance. With a social pool plus personal account structure, it is a mixed system combining pay-as-you-go and partial accumulation programs with defined contribution and defined benefits. The social pool account, designed to reflect social equity (mutual aid), involves a pay-as-you-go defined benefit scheme, whereas personal accounts are designed with a view to total accumulation and involve a defined contribution scheme based on institutional efficiency.

The basic old-age insurance system for enterprise employees involves the following policies:
a basic insurance premium jointly paid by enterprises and employees. The enterprise share will generally not exceed 20% of their total wage bill; employees pay 8% of their wages, with all the payments going to their personal accounts. The self-employed and those in flexible employment in urban areas pay premiums equal to 20% of the local average wage. Enterprise employees who have reached the legal retirement age and have accumulated 15 years or more of contributions are entitled to draw a basic monthly pension made up of a base pension and a personal account pension. The base monthly pension is based on the mean of the previous year’s monthly average wage for employees in that area and the average personal indexed monthly wage for contribution purposes, with 1% of the mean value disbursed for every full year of contributions. The amount of the monthly pension disbursed from an employee’s personal account equals the cumulative savings in the account divided by the number of months for pension payment. The latter figure is based on the average life expectancy of urban residents at the time when the employee retires, retirement age, the interest rate and other factors. The current policy is that employees who retire at 60 get 139 months of pension payment. The state also adjusts the basic pension level with reference to wage increases and price indexation based on the urban cost of living.

China’s rural old-age support is largely provided by the family. Since the 1990s, some regions have implemented an old-age insurance system of personal accounts and total accumulation, based on the principle of “individual payment as the mainstay, collective assistance as the supplement, and government provision of policy support.” In 2004, the government initiated a pilot project in rural areas to provide incentives and assistance for families who abide by the family planning policy. Under this scheme, couples in rural areas with only one child or with two girls will get an average of not less than 600 yuan a year per person from the age of 60 until their death. The cost of the payment will be jointly borne by the central and local governments.

A superannuation scheme has always operated for staff in government agencies and public institutions. Some localities have now started pilot schemes for public sector old-age insurance, but there is no nationally unified policy on old-age insurance for the public sector.

3. Operation of the rural and urban old-age insurance systems

(1) Constant expansion of coverage

At present China’s urban and rural old-age security system covers currently employed staff and retirees in government agencies and public institutions, participants in the insurance scheme for enterprise employees in urban areas and the rural old-age insurance system. By the end of 2007, 40.04 million staff in government agencies and public institutions were covered by their superannuation schemes (the figure for those drawing their pensions is not included here as it has not been calculated by either the National Bureau of Statistics or the Ministry of Labor and Social Security); 201.37 million people were in the basic old-age insurance system for enterprise employees in urban areas (of whom 151.83 million were working and 49.54 million were retirees), rendering it the world’s largest old-age security scheme; and 51.71 million people were

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in the rural old-age insurance scheme.\textsuperscript{2}

The coverage of the basic old-age insurance system for enterprise employees in urban areas has been expanding. During the Tenth Five-Year Plan, the average annual growth rate of participants reached 5.1%, and in 2006 and 2007 the figure rose to 7.3%.

(2) A new pattern of multi-source financing has taken preliminary shape.

The basic old-age insurance scheme for enterprise employees in urban areas is financed jointly from three sources: enterprise premiums, employee premiums and government provision of baseline financial assistance. In 2007, 649.4 billion yuan was paid in premiums by enterprises and employees, with the annual per capita contribution of 4,277 yuan. Different levels of government provided a total of 115.7 billion yuan, of which 87.3 billion came from the central government;\textsuperscript{3} this was used to meet the current gap between the income and the outgoings of the pension fund.

(3) The disbursement of the basic old-age pension has been assured.

During the period 1998-2007, retirees participating in the basic old-age insurance scheme (including those from government organizations and public institutions involved in the pilot old-age insurance reform) increased in number from 27.27 to 49.54 million, disbursements under the scheme rose from 151.2 billion to 596.5 billion yuan, and the monthly per capita pension increased from 413 to 1002 yuan.\textsuperscript{4} The pension was paid in full and on time and without arrears.

(4) A National Social Security Fund has been set up, strengthening the sustainability of the old-age insurance system.

The central government has established the National Social Security Fund, a national pension reserve fund collected by the central government, in order to make up the shortfall in social security when population aging reaches its peak. The scale of the fund’s assets has risen continuously, from less than 10 billion US dollars at the end of 2001 to 500 billion yuan at the end of 2007, over six times the amount held in 2001. Its return on investment has also risen continuously. Since its inception, the fund has obtained an annualized rate of return of more than 11%, indicating a quite satisfactory investment return premised on controlling risk.\textsuperscript{5}

II. Major problems of China’s urban and rural old-age security system

In recent years, the Chinese government, in accord with the demands of social and economic development, has proposed the goals of a social pool for urban and rural development and the basic realization of a social security system covering both urban and rural areas by 2020. To achieve these goal and meet the requirements of balancing rural and urban development and

\textsuperscript{2} Department of Planning and Finance, Ministry of Labor and Social Security, \textit{Labor and social security statistical abstract 2008} (unpublished data), pp. 6-7.


\textsuperscript{4} Department of Planning and Finance, Ministry of Labor and Social Security, \textit{Labor and social security statistical abstract 2008} (unpublished data), pp. 36-38.

\textsuperscript{5} National Council for the Social Security Fund, “Annual report of the National Social Security Fund.”
providing universal old-age security, we must overcome the following problems.

1. **The gap between urban and rural areas and among different urban groups is too wide.**

   (1) There is an imbalance between urban and rural social security systems.

   The current system of basic old-age insurance for enterprise employees in urban areas was founded against a background of rural-urban division. Little effort has been made to construct a rural old-age security system. 727 million farmers are excluded from this security network, and therefore the family remains the mainstay for the elderly in rural areas. As a result, a new “urban-rural dual structure” has come into existence in the social security domain, despite its mission of social equity. This structure is unsuited to the demands of balancing urban and rural development and building a harmonious society.

   (2) There is a wide gap in the benefits received by enterprise employees and those of staff of government agencies and public institutions.

   The reform of the old-age insurance system for enterprise employees started in 1996. However, the superannuation scheme in government agencies and public institutions remains untouched. The two systems have differing institutional models, management systems, finance mechanisms, benefit calculations, eligibility conditions and payment transfer arrangements, and their mechanisms for benefit adjustment are also different. Pensions in the public sector rise in step with the wage increases of current employees in the sector. Retired enterprise employees, on the other hand, have their pensions adjusted as a proportion of the average wage level when appropriate, and in fact their pensions have no institutionalized adjustment mechanism. Consequently, the once similar benefits the two schemes offered before reform have now become increasingly different. In 2007, the monthly per capita pension for retirees from government organizations was 1,639 yuan; for those from public institutions, 1,543 yuan; and for retired enterprise employees, only 947 yuan, a figure that amounts to about 60% of the pensions in the first two categories. This has given rise to a large number of mass petition incidents. At the same time, the excessively wide gap has forced enterprises into continuously and irrationally improving their pension benefits, multiplying the system’s payment risks.

   (3) A lot of people are still unable to receive any old-age security benefit.

   Among the 293 million working people in urban areas, more than 100 million are not covered by the old-age insurance system due to their job instability and low income. Others are not entitled to draw pensions because of their discontinuous participation in the insurance system. No suitable arrangements are available for these two groups. Furthermore, the great majority of farmers have no old-age insurance; and even when a rural old-age insurance system is established, many cannot afford the contributions and thus lack basic old-age security.

2. **The systems are fragmented and confusing**

   (1) Within a fragmented institutional structure, urban and rural areas and different groups are...
covered by different systems.

On the basis of the present situation and short-term trends, China will have at least seven old-age security systems, including basic insurance for enterprise employees in urban areas, the superannuation scheme for staff of government agencies, that for staff of public institutions, basic livelihood security for farmers whose land has been expropriated, old-age insurance for rural migrant workers and farmers, and old-age subsidies for people in urban and rural areas who do not have a secure income. That will lead to a structure in which urban and rural areas and different groups all have different systems, resulting in a fragmented and confused system and unfair institutional treatment of some groups.

(2) The social pool for old-age insurance remains at a low level, and the system is artificially segmented.

The basic old-age insurance system for enterprise employees in urban areas and the one which covers the largest population is flawed by problems such as the low level of the social pool, disparities in premiums and benefit rates, the absence of interregional flows of insurance funds, difficulties in transferring payments and restrictions on payments. These factors have given rise to an unfortunate pattern of institutional segmentation. Only a few provinces have so far succeeded in implementing a genuine social pool at the provincial level; in most regions it remains at the municipal and county level. Insurance premiums vary not only in different parts of the same province, but also among different provinces. For example, the average insurance rate is only 12% in Guangdong, but is more than 20% in Jilin. The low level of the social pool directly leads to the fact that funds cannot be transferred between regions. The difference in the premiums paid by enterprises is responsible for the inequitable investment environment in some regions and for unfair competition among enterprises. Moreover, the fact that it is difficult to transfer payments or make them portable means that they fail to meet the requirements of establishing a unified urban-rural labor market.

(3) The lack of a nationwide system of basic old-age security

A social security system is designed to achieve social equity. However, the fact that the present system gives different groups different levels of benefit through different schemes means that it achieves quite the opposite. With the constant development of society and the economy, it is essential to set up a nationwide pension scheme that enables every citizen to share in the fruits of development and get a fairer share of basic old-age security.

3. The funding responsibilities of different levels of government are not well defined and funding input is not fairly shared between urban and rural areas

(1) The funding responsibilities of the central and local governments are ill-defined. Thanks to the absence of laws and regulations offering a clear-cut definition of the responsibilities of each, local governments are reluctant to collect social security funds or expand coverage. As a result, the shortage of funds has to be made up through transfer payments by the higher authorities, making local governments reliant on ever increasing subsidies from the central authorities.

(2) Funding input to urban and rural areas has been inequitable. Public funding is supposed not to discriminate between citizens and to gradually scale up investment in social security and
other basic needs. But the fact is China’s public funding has long gone exclusively to old-age security in urban areas. Recent years have seen a continuous increase in funding for this item, with central government funding exceeding 70 billion yuan in 2007. In contrast, no funds at all were allocated to rural areas. Moreover, the level of funding input is obviously inadequate. In 2005, funding for social security accounted for just 11.7% of total financial expenditure (public health and education expenditure excluded). This level is lower than that of most developed and even developing countries. Additionally, China has not set up a sound funding input mechanism, a social security budget system, or a stable mechanism for growth in funding input.

4. A multi-level old-age security system has not been established.

China’s old-age insurance system was originally designed as a three-pillar system consisting of basic old-age insurance, supplementary old-age insurance and personal savings in order to solve the problem of old-age security for enterprise employees in urban areas. In reality, however, supplementary old-age insurance has developed quite slowly. At the end of 2007, only 32,000 enterprises had set up enterprise pension schemes. These covered 9,290,000 employees, or no more than 4% of urban employees for that year, with an accumulated per capita contribution of less than 20,000 yuan.

Limited investment channels for funds accumulated from enterprise pensions and personal accounts for basic old-age insurance has considerably constrained the development of supplementary old-age insurance. At present, insurance funds deposited in banks or used to buy government bonds may get poor returns and risk being devalued; if invested in the capital market, which is less developed and poorly regulated, they are even more likely to encounter salient risks. All these render it hard to give full play to the role of the supplementary old-age insurance mechanism.

Moreover, the current old-age insurance system is mainly designed to accommodate groups with an income or who can afford the premiums, while neglecting the needs of people in urban and rural areas who cannot pay. With a view to making “old-age security a reality for everybody,” we need a more basic and noncontributory old-age security system to provide baseline security.

5. Theoretical and policy research on old-age security lags behind.

On the one hand, because of the lag in research, the final goal and strategies for a single system covering both urban and rural old-age security have not been clearly defined, resulting in systemic institutional gaps. We have always hoped to achieve total coverage across urban and rural areas through old-age insurance, but have failed to recognize that it is the absence of a noncontributory old-age welfare system that prevents the system from achieving total coverage even in developed regions. On the other hand, there is disagreement on the direction of the reforms; both research and policy lag behind developments in society. For example, theoretical and policy research is unable to meet the urgent demand for reform on issues like the model

and framework for rural old-age security, the reform of government organizations and public institutions, transfer of and continuity in basic old-age insurance, giving substance to personal accounts, and raising the social pool level; nor does it deal with the shortfall in contributions during what is seen as the contributory years of the group who are working but will retire within a few years after the implementation of personal old-age insurance accounts. This leaves the reforms suspended, bogged down, or beset by accumulated problems. Moreover, theoretical and policy research also falls far behind the urgent demands of the development of social security reform with regard to the division of responsibility and funding between central and local authorities, as well as between provincial governments and those at the municipal and county levels. Consequently, there has been no progress over the years in constructing a rural old-age security system, and no solution has been found for problems relating to the social pool level and the transfer and continuity of old-age insurance for urban enterprise employees.

III. Prospects for China’s urban and rural old-age security system

At present, with the rapid development of the national economy, fast revenue growth, and the adoption of balanced urban and rural development and the building of a harmonious society as governance ideas, one could say that relatively good social and political conditions and material foundations exist for the major undertaking of developing China’s old-age security system. The stated goal is that “a social security system covering both urban and rural residents will be basically established and basic livelihood security will be available to everybody” by 2020. According to this goal, China’s old-age security system will adhere to the principles of a low rate (securing the basic level), wide coverage, multiple levels, a single plan covering the urban and the rural, and the linking up of different types of insurance. This will enable the establishment of a multi-level old-age security system that will include an old-age subsidy in urban and rural areas and basic and supplementary old-age insurance, so that every citizen will enjoy old-age security.

1. Progressively set up old-age subsidy system for urban and rural residents without income security.

Both farmers (a self-employed group) and people employed in a flexible manner are informally employed. Their main characteristic is receipt of a low and unstable income. These groups, especially farmers, have little capacity to pay. Those in this position should therefore be excused from participation in the contributory old-age insurance system. The social insurance practice of other countries shows that it has always been difficult to extend insurance cover to such people. Furthermore, some unemployed urban residents also find it hard to participate in the insurance system. Accordingly, it is necessary to establish an old-age subsidy system for urban and rural residents without income security. It should be a low-level, noncontributory subsidy (picked up by national revenue) covering all people in need (farmers and urban residents without income security). However, a unified national system cannot be expected until conditions are

11 He Ping and Hua Yingfang, *On the social security of the informally employed*, p. 57.
ripe; in the meantime, regions where the right conditions exist can go first.

2. **Improve the basic old-age insurance system for urban employees through three steps.**

First, China must achieve a social pool of basic old-age insurance at the provincial level as soon as possible. In the early stages of implementation, this may start with budgetary management at the provincial level. Thence it should transit as quickly as possible to unified policy, unified receipts and expenditure, and line management, to achieve a genuine social pool at the provincial level.

Second, we should give substance to the system of personal accounts for basic old-age insurance. The main aims of this measure will be to guard against the risks involved in population aging and to separate the social pool from personal accounts, with a view to preparing for a national-level social pool for the base pension.

Third, the base pension should be pooled nationally and managed exclusively by the central government. It should receive employer funding in the form of social insurance premiums (or through taxes), while the central government would be responsible for baseline input. Prior to the implementation of this scheme at the national level, transitional measures for old-age insurance for rural migrant workers should be introduced and kept in operation until a nationwide social pool is realized, at which point migrant workers can participate in the unified old-age insurance scheme for enterprise employees.

Farmers whose land has been expropriated may continue to receive their livelihood security benefits, if any; but those of working age will gradually be transferred to the old-age insurance system for urban employees.

3. **Reform the superannuation pension scheme of government agencies and public institutions.**

Taking into account the historical evolution of these institutions and the current state of affairs, we should make three points clear in promoting the reform of this scheme: the intention of the reform is to improve the system and not simply to reduce governments’ financial burden; the reform procedure involves simultaneous execution of the reforms in government agencies and public institutions, with possible pilot projects being initiated in public institutions; and the public sector system should be consistent with the private sector (enterprise) one.

To ensure the smooth articulation of old-age benefits for public sector staff, it will be necessary to carry out these measures in step with a compulsory system of occupational superannuation. This would be jointly funded by individuals and their employers, with a trust management model adopted with reference to enterprise superannuation.

4. **Set up personal accounts for farmers on a voluntary basis to ensure old-age security for them**

Given that farmers are self-employed and have a low capacity to make premium payments, it is hard to replicate the urban model of combining the social pool and personal accounts in the rural system of old-age insurance. The current pilot projects for rural old-age insurance in various areas are personal account plans based on voluntary participation. They can be further improved; moreover, guidelines should be produced as soon as possible to standardize pilot projects in different localities. The practice of other countries shows that rural old-age insurance is not
viable without public funding. Therefore, to encourage participation by farmers who can afford it, local governments should be required to provide an appropriate subsidy at the contribution or benefit stage (the experience of some developed countries\textsuperscript{12} indicates that the subsidy should account for at least 30\% of the participant’s payment).

5. Looking ahead while keeping the present situation in mind; deal with the following urgent short term issues

(1) Raise the social pool level of basic old-age insurance for urban employees, give substance to the system of personal accounts and achieve a social pool for the base pension at a national level before 2015.

A timetable is needed for raising the social pool level. In the short term, we should promote as quickly as possible the transition of the social pool from the municipal and county level to the provincial level, and realize a genuine social pool at the provincial level in three years. At the same time, we should further expand the scope of giving substance to personal accounts and encourage those regions with capability and willingness to take the lead to spend five to eight years in gradually making these account substantive. Moreover, the national-level social pool for the base pension must be achieved before 2015.

(2) Adopt a cautious strategy for reforming the superannuation system in government agencies and public institutions.

This reform may set off a chain of events, so it should be planned cautiously and implemented steadily. Pilot projects could be launched first in public institutions in some regions and then progressively extended to government organizations. Once the pilots are successful, they can be promoted across the whole country.

The reform of the old-age insurance system in the public sector should start from a high point with the direct implementation of a social pool at the provincial level, followed by a gradual transition to one at the national level. While establishing a basic old-age insurance system, we ought to set up a compulsory system of occupational superannuation, ensure a smooth transition from pre-reform to post-reform pensions, and guarantee the rights of participants.

(3) Adopt a transitional strategy for old-age insurance for migrant workers before the establishment of a social pool at the national level.

There is still a long way to go before we realize a national-level social pool for the base pension. Until then, to protect the legitimate rights of migrant workers who work away from home, China needs to come up with a strategy for migrant workers’ old-age insurance as quickly as possible, in accordance with the requirements of Document No. 5 of the State Council in 2006, and encourage the implementation of this strategy at the local level.

During the formulation of this strategy, the rights of migrant workers should be given full consideration. Most or all of the payment by employers should be placed in migrant workers’ personal accounts and should move with them, so that they will not be institutionally deprived of their legitimate rights.

\textsuperscript{12} Hua Yingfang, “Overseas rural old-age insurance: experiences and implications,” p. 144.
(4) Formulate a strategy for transferring and interconnecting basic old-age insurance across different regions.

With the formation of a nationally unified labor market, there has been increasing cross-regional employment. This makes the transfer and interconnection of basic old-age insurance arrangements a very urgent issue. Therefore, we need to formulate at the earliest possible date a method of cross-regional transfer and interconnection of insurance arrangements in order to solve the problem of regional divergence and truly protect the legitimate rights of insurance participants.

(5) Further investigate and develop a rural old-age insurance system.

China needs to promulgate as soon as possible a nationwide policy for guiding different regions to carry out new types of rural old-age insurance. Uniformity should not be imposed on such schemes. Employees of township enterprises (local farmers) could participate directly in the basic old-age insurance for urban employees. Economically developed regions in eastern China should be encouraged to change rural old-age insurance targeted purely on farmers into the basic old-age insurance for urban employees.

(6) Establish a system of subsidies for the old to gradually solve the problem of basic old-age security for the urban and rural population without income security.

Given that basic old-age security is unavailable to low-income people with flexible employment, the urban unemployed, and the nearly half of all farmers who cannot afford to participate in the insurance system, China should encourage more developed regions to set up an old-age subsidy system for the population without income security, and provide old people who have reached a certain age with a direct subsidy from local government revenue. As the rural population gradually decreases and the coverage of basic old-age insurance for urban employees continues to expand, we should have established, by 2020, an old-age subsidy system covering both urban and rural areas throughout China. Finally, it should be possible to integrate the old-age subsidy and the base pension as a part of basic old-age insurance for urban employees into a citizen’s pension with Chinese characteristics.

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